providing essential air service between the eligible place and its hub, unless otherwise agreed to with the community. In cases where an eligible place receives service to two hubs, however, more than one intermediate stop is permitted between that place and its secondary hub.

(b) In Alaska, more than one intermediate stop is permitted if required by low traffic levels at the eligible place or by the long distance between the eligible place and its hub.

(c) The Department may specify nonstop service when necessary to make the service viable.

(d) Where an eligible place normally is an intermediate stop that shares available capacity with another place, it is the policy of the Department either to require additional capacity (more flights or larger aircraft) between the eligible place and its hub or to specify some turnaround operations on that route segment.

§ 398.9 Load factor standards.

The load factor standards used in this part may be raised for individual eligible places under either of the following circumstances:

(a) The place is served by the carrier as part of a linear route; or

(b) It would be in the interest of the community, the carrier, or the general public to raise the load factor standard for that place.

§ 398.10 Overflights.

The Department considers it a violation of 49 U.S.C. 41732 and the air service guarantees provided under this part for an air carrier providing essential air service to an eligible place to overfly that place, except under one or more of the following circumstances:

(a) The carrier is not compensated for serving that place and another carrier is providing by its flights the service required by the Department's essential air service determination for that place;

(b) Circumstances beyond the carrier's control prevent it from landing at the eligible place;

(c) The flight involved is not in a market where the Department has determined air service to be essential; or

(d) The eligible place is a place in Alaska for which the Department's essential air service determination permits the overflight.

§ 398.11 Funding reductions.

(a) If, in any fiscal year, appropriations for payments to air carriers remain at or below the amounts estimated as necessary to maintain subsidy-supported essential air service at the places receiving such service, and Congress provides no statutory direction to the contrary, appropriations shall not be available for essential air service to otherwise eligible places within the 48 contiguous States and Puerto Rico that have a rate of subsidy per passenger in excess of $200.00, or are located:

(1) Less than 70 highway miles from the nearest large or medium hub airport;

(2) Less than 55 miles from the nearest small hub airport; or

(3) Less than 45 highway miles from the nearest nonhub airport that has enplaned, on certificated or commuter carriers, 100 or more passengers per day in the most recent year for which the Department has obtained complete data.

(b) The rate of subsidy per passenger shall be calculated by dividing the annual subsidy in effect as of July 1 of the prior fiscal year by the total origin-and-destination traffic during the most recent year for which the Department has obtained complete data.

PART 399—[AMENDED]

171. The authority citation for part 399 is revised to read as follows:

Authority: 49 U.S.C. Chapters 401, 411, 413, 415, 417, 419, 461.

§ 399.20, 399.38, 399.90 [Removed]

172. Sections 399.20, 399.21, 399.38, and 399.90 are removed.

§ 399.21 [Amended]

173. In § 399.21, remove the words ''section 401 of the Act'' and add, in their place, the words ''section 41102 of Title 49 of the United States Code''.

Issued in Washington DC, on August 14, 1995.

Mark L. Gerchick,

Acting Assistant Secretary for Aviation and International Affairs.

[FR Doc. 95–20502 Filed 8–21–95; 8:45 am]

BILLING CODE 4910–62–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 20, 25 and 602

[TD 8612]

RIN 1455–AM85

Income, Gift and Estate Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the income tax imposed under chapter 1, the estate tax imposed under chapter 11, and the gift tax imposed under chapters 12 and 14 of the Internal Revenue Code of 1986. Changes to the marital deduction provisions of the estate and gift tax chapters were made by the Technical and Miscellaneous Revenue Act of 1988. Further amendments were made by the Revenue Reconciliation Act of 1989, and the Revenue Reconciliation Act of 1990. These final regulations will provide guidance needed to comply with the changes to the marital deduction provisions of the estate and gift tax chapters.

DATES: These regulations are effective August 22, 1995.

These regulations apply to decedents dying and to gifts made after August 22, 1995.

FOR FURTHER INFORMATION CONTACT: Susan B. Hurwitz, 202–622–3090, not a toll-free number.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545–1360. The estimated annual burden per respondent/recordkeeper varies from 30 minutes to 3 hours, depending on individual circumstances, with an estimated average of 2 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer PC:FP, Washington, DC 20224, and to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Background

A notice of proposed rulemaking was published in the **Federal Register** (58 FR 305), on January 5, 1993, reflecting amendments made to the Code by the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100–647) (the 1988 Act), the Revenue Reconciliation Act of 1989 (Pub. L. 101–239) (the 1989 Act), and the Revenue Reconciliation Act of 1990 (Pub. L. 101–508) (the 1990 Act). The 1988, 1989, and 1990 Acts impose restrictions on the allowance of the estate and gift tax marital deduction where the surviving spouse (in the case of a transfer at death) or the donee spouse (in the case of a lifetime transfer) is not a citizen of the United States. In addition, the gift tax annual exclusion allowable in the case of a transfer to a

noncitizen spouse was increased to $100,000. The statutory amendments also changed the tax rate and the amount of the unified credit applicable in the case of the estate of a decedent nonresident not a citizen of the United States (nonresident alien). The IRS received written comments on the proposed regulations and, on April 2, 1993, held a public hearing on the regulations.

After consideration of the written and oral comments received, § 20.2056A–2(d) of the proposed regulations, which provides additional requirements for qualification as a qualified domestic trust to ensure the collection of the section 2056A estate tax, was substantially modified. In view of these substantial modifications, § 20.2056A–2(d) has been reissued as proposed and temporary regulations in order to afford the public a further opportunity to comment on these security arrangements. See the proposed rules and the rules portion of this issue of the **Federal Register**, respectively. The balance of the proposed regulations are revised and adopted as final regulations by this Treasury decision.

The following is a discussion of the more significant comments received (other than those comments pertaining to § 20.2056A–2(d) of the proposed regulations) and the reasons for accepting or rejecting those comments in the final regulations.

A. Section 1.1015–5 Increased Basis for Gift Tax Paid in the Case of Gifts Made After December 31, 1976

This section of the proposed regulations has been revised to better conform to the existing regulations and to clarify the determination of the amount of the gift tax paid in situations where the donor's unified credit is applied against the gift tax liability.

B. Section 20.2056A–1 Restrictions on Allowance of Marital Deduction if Surviving Spouse is Not a United States Citizen

Under section 2056(d)(4), if the surviving spouse becomes a citizen of the United States before the day on which the estate tax return is filed, property passing from the decedent to the surviving spouse either outright or in trust need not be transferred to a qualified domestic trust (QDOT) (or the trust need not be reformed to qualify as a QDOT) in order to qualify for the estate tax marital deduction. It is possible that the naturalization process may not be completed before the due date, including extensions, for filing the estate tax return. Comments suggested that if the surviving spouse has filed an application for naturalization within a reasonable time after the decedent's death, then any late filing of the return pending the outcome of the citizenship process should be treated as due to reasonable cause for purposes of section 6651 (imposing penalties for failure to file returns and failure to pay tax). This suggestion was not adopted because the existence of reasonable cause for late-filing and late-payment should be determined on a case by case basis applying well-established standards as prescribed under current law.

In response to comments, the discussion in § 20.2056A–1(c) of the proposed regulations, regarding the special rule for estate and gift tax treaties, was expanded. Section 7815(d)(14) of the 1989 Act added a special rule under which the statutory amendments affecting the estate and gift tax marital deduction do not apply when the decedent or donor is not a United States citizen or resident and is a resident of a country with which the United States has an estate, gift or inheritance tax treaty, to the extent such statutory amendments would be inconsistent with the treaty provisions. The final regulations provide that under this special rule, the estate may choose either the statutory deduction under section 2056A or the marital deduction, exemption, or credit allowed under the treaty. See H. Rep. No. 247, 101 Cong. 1st Sess. 1435, n. 99 (September 20, 1989). Thus, the estate may not avail itself of both the marital benefit under the treaty and the marital deduction under the QDOT provisions of the Code with respect to the remainder of the marital property that is not otherwise deductible under the treaty. These regulations do not conflict with existing treaties.

C. Section 20.2056A–2 Requirements for Qualified Domestic Trust

Under § 20.2056A–2(a) of the proposed regulations, in order to qualify as a QDOT, a trust must be created and maintained under the laws of the United States or any state or the District of Columbia. Several commentators suggested that this requirement should be deleted because it places an additional burden on nonresident aliens with only limited contacts with the United States. This comment was not adopted. The ability of the Internal Revenue Service to collect the section 2056A estate tax is adequately protected only if the trust has a sufficient nexus with the United States. However, the final regulations delete the requirement that the trust be created under the laws of the United States. In lieu of that requirement, the final regulations provide that the trust may be established by a document executed under the laws of either the United States or a foreign jurisdiction, such as under a foreign will or trust, provided that the document directs that the laws of a particular state of the United States or the District of Columbia govern the administration of the trust, and that direction is effective under the applicable local law. The final regulations also clarify that a trust is ''maintained'' in the United States for purposes of this provision if the records of the trust (or copies thereof) are kept in the United States.

Section 20.2056A–2(a) of the proposed regulations also provided that in order to qualify as a QDOT, a trust must constitute an ''explicit trust'' as defined in § 301.7701–4(a) of the regulations. The final regulations change this reference to an ''ordinary trust'', since that is the term referred to in § 301.7701–4(a). Some commentators raised the concern that if property transferred to a QDOT includes an active trade or business, the trust may be classified as an association taxable as a corporation under § 301.7701–2 and, therefore, will not qualify as a QDOT. In response to those comments, the final regulations provide that a trust will not fail to be treated as an ordinary trust under § 301.7701–4(a) for purposes of section 2056A solely because of the nature of the assets transferred to that trust.

D. Section 20.2056A–3 QDOT Election

Comments were received recommending that the protective election rules contained in § 20.2056A–3(c) of the proposed regulations be expanded to permit protective elections with respect to a broader range of controversies affecting the availability of the marital deduction for property passing to or for the benefit of a noncitizen spouse and the time period during which such controversies must arise. In response to these comments, the availability of a protective election has been revised to cover additional situations. The final regulations provide that a protective election may be made only if a bona fide issue is presented, the resolution of which is uncertain at the time the federal estate tax return is filed. The bona fide issue must concern the residency or citizenship of the decedent, the citizenship of the surviving spouse, whether an asset is includible in the decedent's gross estate, or the amount or nature of the property the surviving spouse is entitled to receive. Conforming changes have been made to the protective assignment rules

of the proposed regulations to reflect these amendments.

Under § 20.2056A–3(b) of the proposed regulations, partial QDOT elections were not permitted. However, the proposed regulations provide that if a trust is severed in accordance with the rules under section 2056(b)(7), a QDOT election may be made for each separate trust. A comment was received stating that the phrase ''for each separate trust'' implies that if there are two or more trusts after division, an election must be made for each trust. The final regulations clarify that upon severance of a trust, a QDOT election may be made for any one or more of the severed trusts.

E. Section 20.2056A–4 Procedures for Conforming Marital Trusts and Nonmarital Transfers to the Requirements of a Qualified Domestic Trust

A comment was received pointing out that the proposed regulations did not specify the time by which a nonjudicial reformation must be completed. Accordingly, the final regulations provide that a nonjudicial reformation must be completed by the time prescribed (including extensions) for filing the decedent's estate tax return. This result is consistent with section 2056(d)(5)(A), which provides that absent a judicial reformation the determination of the qualification of a trust as a QDOT is made as of the date the return is filed.

Section 20.2056A–4(a)(2) of the proposed regulations provide that a trust, as reformed, must be effective under local law and irrevocable. A trust in which the surviving spouse has an income interest and an inter vivos general power of appointment is, in effect, revocable and could, therefore, fail to qualify under the proposed regulations. Accordingly, the final regulations have been amended to provide that the trust as reformed may be revocable by the spouse, or otherwise be subject to the spouse's general power of appointment, provided that there is no power exercisable by any person to amend the trust during the continued period of its existence such that it would no longer qualify as a QDOT. Thus, for example, any distributions made pursuant to the spouse's exercise of a power to appoint must be subject to the requirement that the U.S. Trustee withhold the section 2056A estate tax.

The final regulations provide that prior to the time a judicial reformation of the trust is completed, the trustee is responsible for filing the Form 706–QDT, paying any section 2056A estate tax that becomes due, and filing the annual report if such a report is required. In addition, failure to comply with these requirements may cause the trust to be subject to the anti-abuse rule under § 20.2056A–2T(d)(1)(iv). A claim for refund may be filed to recover any section 2056A estate tax paid by the trust if the judicial reformation is terminated prior to completion. In addition, if the judicial reformation is terminated prior to completion, the trustee of the trust is liable for the additional estate tax on the decedent's estate that becomes due at the time of the termination due to the trust's failure to comply with section 2056A.

Comments were received criticizing the rule contained in § 20.2056A–4(b)(5) of the proposed regulations, that a transfer of property by the surviving spouse or the decedent's executor to a QDOT created by the spouse pursuant to section 2056(d)(2)(B) is treated as a transfer from the decedent solely for purposes of section 2056(d)(2)(A). For all other purposes, e.g., income, gift, estate, generation-skipping transfer tax and section 1491, the proposed regulations provide that the property is treated as passing from the surviving spouse to the trust. The comments suggested that although section 2056A(b)(15) provides for tax exempt reimbursement to the spouse of income taxes paid by the spouse with respect to trust items, that provision should not be interpreted as acknowledging that all QDOTs created by the surviving spouse or by the decedent's executor are grantor trusts for income tax purposes.

The final regulations retain the rule that the surviving spouse is treated as the transferor of the property transferred to a QDOT pursuant to section 2056(d)(2)(B). It is believed that this treatment is consistent with Congressional intent, as evidenced by section 2056A(b)(15). However, because of the potentially unanticipated result in the case of completed transfers to trusts by the surviving spouse where the spouse retains an income interest, § 25.2702–1(c) of the regulations is amended by this document to provide that property assigned or transferred to a QDOT by the surviving spouse, where the surviving spouse retains an income interest in the transferred property, is not subject to the special valuation rules of section 2702. See § 25.2702–1(c)(8). The final regulations also provide that the surviving spouse is not considered the transferor of property to a QDOT if the transfer by the spouse constitutes a transfer that satisfies the requirements of section 2518(c)(3).

Section 20.2056A–4(b) of the proposed regulations provide that if property is transferred or assigned to a QDOT by the surviving spouse pursuant to section 2056(d)(2)(B), the QDOT need not be a trust that would otherwise qualify for a marital deduction under section 2056(a). A question has been raised whether this rule applies regardless of whether the trust was created by the decedent during life or by will, by the surviving spouse, or by the decedent's executor. Accordingly, the final regulations clarify that if the spouse transfers property to a QDOT pursuant to section 2056(d)(2)(B), the transferee trust need not (with one exception) be in a form necessary to qualify for a marital deduction under section 2056(a) regardless of whether the trust is created by the decedent, the surviving spouse or the decedent's executor. However, the final regulations provide that, once funded, 100 percent of the transferee trust must consist of assets that qualify for the marital deduction under the Code. This rule is necessary to avoid complicated tracing issues under section 2056A(b)(1). Therefore, if the decedent also bequeaths property to the trust under his will, the trust will need to conform to the marital trust requirements in order that all of the trust property qualifies for the marital deduction under section 2056(a).

Section 20.2056A–4(b)(3) of the proposed regulations provide that only assets passing from the decedent to the spouse that are included in the decedent's gross estate may be transferred or assigned to a QDOT. The language of the proposed regulations could be viewed as providing that assets originally owned at any time by the surviving spouse cannot be assigned to the QDOT, even if those assets in fact are included in the decedent's gross estate. For example, a question has been raised whether property owned by the surviving spouse that was transferred to the decedent and then subsequently bequeathed to the surviving spouse could be transferred or assigned to a QDOT. In order to address this concern, the final regulations have been clarified to provide that the surviving spouse may transfer or assign to the QDOT any property included in the decedent's gross estate and passing to the spouse at death. However, the spouse may not transfer property owned by the spouse at the time of the decedent's death, in lieu of property passing from the decedent.

In response to comments, the final regulations specifically address the transfer or assignment of property to a QDOT in the case of the death or incompetency of the surviving spouse. The final regulations provide that the transfer or assignment of property to a

QDOT may be made by either the surviving spouse, the surviving spouse's legal representative (if the surviving spouse is incompetent), or by the surviving spouse's executor (if the surviving spouse subsequently dies).

Comments were received suggesting that the method adopted in § 20.2056A–4(c)(4) of the proposed regulations for computing the ''corpus portion'' of a nonassignable annuity payment be revised. The comments suggested that the corpus portion of each payment should be computed based on that portion of each payment excluded from the spouse's income under section 72. Alternatively, it was suggested that the determination of the corpus portion should be keyed to the threshold for imposition of the section 4980A excise tax on excess distributions (generally amounts distributed in excess of $150,000). Both of these suggestions were rejected. The methodology in the regulations is designed to realistically approximate the portion of each payment representing income and corpus based on the present value of the benefit, the expected term of the annuity, and the assumed rate of return. On the other hand, basing the determination on the extent to which each payment is included in the spouse's income would produce arbitrary and unrealistic results. For example, in the case of a noncontributory qualified plan, the entire payment will be includible in gross income and thus no portion would be allocated to corpus. Similarly, under the section 4980A approach, the first $150,000 of payments will be arbitrarily allocated to income regardless of the amount of the total annual payment. It is believed that neither of these methods provides an accurate or realistic measure of the income or corpus portion of each payment.

Guidance was requested regarding whether an individual retirement account (IRA) described in section 408(a) is a nonassignable annuity or other arrangement eligible for the procedures contained in § 20.2056A–4(c). In general, individual retirement accounts under section 408(a) are assignable but individual retirement annuities under section 408(b) are not assignable (and thus, are eligible for the special procedures described in § 20.2056A–4(c)). However, if an individual retirement account is assigned to a trust with respect to which the surviving spouse is not treated as the owner under section 671 et seq. (providing rules for the treatment of grantor trusts), then the entire account balance is treated as a distribution to the spouse includible in the spouse's gross income under section 408(d) in the taxable year in which the assignment is made.

In view of this significant tax burden attendant to the assignment of an individual retirement account to a nongrantor trust, the final regulations allow the spouse to treat the individual retirement account as nonassignable for purposes of § 20.2056A–4(c) and thus, eligible for the procedures contained in that section. However, if the spouse does assign the individual retirement account to a trust pursuant to §§ 20.2056A–2(b)(2) and 20.2056A–4(b) (either a grantor trust or a nongrantor trust), then § 20.2056A–4(b)(7) (providing that an assignment of an assignable annuity or other arrangement to a trust is treated as a transfer of the property to a QDOT regardless of the method of payment actually elected) will apply. Thus, under the final regulations, if the individual retirement account is assignable, the spouse has the option of either assigning the individual retirement account to a QDOT, or using the procedures contained in § 20.2056A–4(c).

In response to comments, § 20.2056A–4(c) of the proposed regulations has been modified to provide that if the financial circumstances of the spouse are such that an amount equal to all or a part of the corpus portion of a nonassignable annuity payment received by the spouse would be eligible for a hardship exemption (as defined in § 20.2056A–5(c)), if paid from a QDOT, then all or a corresponding part of the payment will be exempt from the rollover or the tax payment requirements, depending upon which option is selected by the spouse.

In response to comments, the agreements required under § 20.2056A–4(c) of the proposed regulations (pertaining to the spouse's undertaking to roll over nonassignable annuity payments to a QDOT or pay a section 2056A estate tax on each payment) have been revised. In the final regulations, both forms of agreements provide that in the event of a failure to timely file the Form 706–QDT or a failure to either (1) timely pay the section 2056A estate tax on the corpus portion of the annuity payment, or (2) timely roll over the corpus portion to a QDOT, the surviving spouse may make an application for relief under § 301.9100–1 of the Procedure and Administration Regulations, from the consequences of the failures. This is in lieu of the automatic acceleration of the balance of the section 2056A estate tax as provided in the proposed regulations.

Under the proposed regulations, both forms of agreements provided that the surviving spouse must agree, at the request of the District Director (or the Assistant Commissioner (International) in the case of a surviving spouse of a nonresident alien decedent or a surviving spouse of a United States citizen who died domiciled outside the United States) to enter into a security agreement to secure the spouse's undertakings under the agreement. Comments were received objecting to the open-ended nature of this security requirement. In response to these comments, the final regulations have been amended so that this provision applies only in those cases in which the plan or arrangement from which the annuity will be paid is established and administered by a person or entity that is located outside of the United States. In the case of these foreign plans, additional security requirements may be necessary to assure collectibility of the section 2056A estate tax.

F. Section 20.2056A–5 Imposition of the Section 2056A Estate Tax

Comments were received regarding § 20.2056A–5(c)(2) of the proposed regulations which provides that items will be characterized as ''income'' for purposes of section 2056A(b)(3)(A) and section 2056A(c)(2) based on applicable state law, regardless of the terms of the instrument. Commentators maintained that this provision created unnecessary complexity in the administration of QDOTs in jurisdictions with no statutes governing allocation of receipts between principal and income. The commentators suggested that if local law or statutory law is silent regarding treatment of an item, the allocation of the item should be based on the terms of the governing instrument with certain specified exclusions (such as capital gains). This suggestion was not adopted, in part, because the grant of this broad discretion would not be consistent with the legislative history underlying section 2056A(b)(1). Instead, the final regulations provide that when local law is silent, reference will be made to general principles of law (such as, for example, the Uniform Principal and Income Act) and that these principles will override any provisions to the contrary in the governing instrument. In addition, the final regulations provide that for purposes of section 2056A(b)(3)(A), ''income'' does not include (in addition to the exclusion for capital gains) items constituting income in respect of a decedent under section 691, regardless of the characterization thereof under local law, except to the extent provided in administrative guidance published by the Service. The IRS added this exclusion because it is

believed that local law may inappropriately characterize certain items of IRD (income in respect of a decedent) as income, contrary to the purposes of section 2056A, and it was determined that exceptions to this rule of exclusion should be made on a case by case basis. However, in cases where a QDOT is designated by the decedent as a beneficiary of a pension or profit sharing plan described in section 401(a), or an individual retirement account or annuity described in section 408, the proceeds of which are payable to the QDOT in the form of an annuity, the final regulations provide that any payments received by the QDOT may be allocated between income and corpus using the method prescribed under § 20.2056A–4(c) for determining the corpus and income portion of an annuity payment.

A comment was received recommending revision of § 20.2056A–5(c)(3) of the proposed regulations to specifically authorize nontaxable reimbursement to the spouse for income taxes for which the spouse is liable if the spouse receives a lump sum distribution from a qualified plan and assigns the distribution to the QDOT. In response to this comment, the final regulations have been modified to provide that amounts paid from the QDOT to reimburse the spouse for such income taxes are not subject to the section 2056A estate tax. In addition, the provisions for nontaxable distributions to the spouse contained in section 2056A(b)(15) (regarding reimbursement for certain income taxes paid by the spouse) have been incorporated into § 20.2056A–5(c)(3) of the final regulations to ensure completeness. With respect to the amount of the reimbursement, the final regulations provide that the amount of tax eligible for reimbursement is the difference between the income tax liability of the spouse (as reported on the spouse's income tax return) and the spouse's income tax liability determined as if the item had not been included in the spouse's gross income in the applicable taxable year.

In response to comments, the definition of a hardship distribution has been expanded. Under the final regulations, a distribution to the spouse is deemed made on account of hardship if the distribution is made to the spouse from the QDOT in response to an immediate and substantial financial need relating to the spouse's health, maintenance, education or support, or the health, education, maintenance or support of any person that the surviving spouse is legally obligated to support.

One comment suggested modifying the regulations to provide that in making a distribution, the trustee may rely upon a statement by the surviving spouse claiming hardship under the regulations. It was decided that this change not be made. Trustees must frequently make decisions concerning whether a distribution is warranted under a particular standard under the trust document. It is believed that a QDOT presents no special circumstances that would justify a deviation from normal fiduciary practices under these circumstances.

Language has been added to the final regulations to further clarify what assets are considered ''reasonably available'' to the surviving spouse for purposes of determining whether the assets must be liquidated before a hardship distribution may be made. The final regulations provide that assets such as closely held business interests, real estate and tangible personalty are not considered assets that are reasonably available.

G. Section 20.2056A–6 Amount of Tax

Under the proposed regulations, in computing the estate tax imposed under section 2056A(b)(1)(B) on the death of the surviving spouse, a credit for state or foreign death taxes under sections 2011 or 2014, respectively, is allowable only if the state or foreign jurisdiction actually imposed additional tax on the QDOT at the time of the taxable event (i.e., only if the jurisdiction had a statutory provision similar in effect to section 2056A). A comment was received that this limitation was inappropriate and was not consistent with the legislative history underlying section 2056A(b)(10). See 136 Cong. Rec. H7147 (daily ed. Aug. 3, 1990). In response to this comment, the final regulations provide that if state or foreign death taxes are paid by the surviving spouse's estate with respect to the QDOT (because the QDOT is included in the surviving spouse's gross estate for state or foreign tax purposes), the taxes are creditable to the extent provided in sections 2011 or 2014 in computing the section 2056A estate tax. In addition, the final regulations provide that state or foreign death taxes previously paid by the decedent/transferor's estate are also creditable within the section 2011 or 2014 framework. A new example has been added to the final regulations to illustrate this application of the state death tax credit.

H. Section 20.2056A–7 Allowance of Prior Transfer Credit Under Section 2013

The proposed regulations provided that the ''first limitation'' in determining the allowable section 2013 credit with respect to the section 2056A estate tax imposed on the spouse's death is deemed to be the section 2056A estate tax imposed. This approach was adopted to avoid certain computational and interpretative problems that would be presented if the methodology described in section 2013(b) and § 20.2013–2 was used. The final regulations retain this approach.

In order to ensure consistency, the final regulations adopt two additional modifications to the section 2013 regime in computing the allowable credit with respect to the section 2056A estate tax. Under § 20.2013–4(a), the amount of the transfer, based on which the ''first limitation'' and ''second limitation'' are determined, is the value at which the property was included in the transferor's gross estate. Further, under § 20.2013–4(b), the amount of the transfer is reduced by any estate and inheritance taxes payable out of the property transferred to the transferee decedent. However, under § 20.2056A–7, the ''first limitation'' is the amount of the section 2056A estate tax determined based on the value of the QDOT on the death of the transferee spouse and any corpus distributions made prior to that time that were subject to tax under section 2056A(b)(1)(A). This same value should be used in determining the ''second limitation.'' Further, since the entire value of the QDOT, unreduced by the amount of the section 2056A estate tax, is included in the transferee spouse's gross estate (see section 2053(c)(1)(B)), this amount (unreduced by the section 2056A estate tax) should be used in determining the ''second limitation''. Otherwise, the credit mechanism will not adequately avoid the double taxation the credit was intended to alleviate in the case of property which has appreciated since the death of the first decedent, and would confer an unintended windfall in the case of property which has declined in value. Accordingly, the final regulations provide that, for purposes of the ''second limitation'' as described in section 2013(c), the value of the property transferred to the decedent is the value of the QDOT on the date of death of the surviving spouse. This value is not reduced by the section 2056A estate tax imposed at the time of the spouse's death. An example has been added illustrating the computation of the prior transfer credit.

I. Section 20.2056A–8 Special Rules for Joint Property

Several comments were received concerning the proper interpretation of sections 2056(d)(1) and 2056(d)(2) where joint property passing to a spouse is transferred by the spouse to a QDOT. Section 2056(d)(1) provides that if the surviving spouse is not a citizen then, except as provided in section 2056(d)(2), no marital deduction is allowed and section 2040(a), rather than section 2040(b), applies in determining the extent to which the joint property is included in the decedent's gross estate. Section 2056(d)(2) provides, inter alia, that section 2056(d)(1) does not apply to any property passing to a QDOT. Comments have been received suggesting that under a literal interpretation of these provisions, if joint property includible in the decedent's gross estate is transferred by the surviving spouse to a QDOT, the provisions of section 2056(d)(1)(B) do not apply and, therefore, section 2040(b) (and not section 2040(a)) would apply to determine the extent to which the joint property is included in the gross estate. The final regulations do not adopt this comment. The statutory provisions should be interpreted as providing that section 2040(a) applies in all events in determining the extent to which spousal joint property is includible in the gross estate, regardless of whether the spouse transfers the property to a QDOT. Under section 2056(d)(2), any property so includible will qualify for the marital deduction if it is timely transferred to a QDOT. The result of the suggested interpretation would be circular in effect: the gross estate would be continually reduced by transfers of property to the QDOT and the size of the gross estate would affect the amount that would need to be transferred to the QDOT so that no net estate tax would be due.

Commentators requested clarification of the ''consideration furnished'' rule contained in § 20.2056A–8(a)(2) of the proposed regulations has been clarified. This rule provided that for purposes of applying section 2040(a), in determining the amount of consideration furnished by the surviving spouse, any consideration furnished by the decedent with respect to the acquisition of the property before July 14, 1988, is treated as consideration furnished by the surviving spouse to the extent that the consideration was treated as a gift to the spouse under section 2511, or to the extent that the decedent elected to treat the transfer as a gift to the spouse under section 2515 (prior to repeal by the Economic Recovery Tax Act of 1981). Under the proposed regulations, this special rule was applicable only if the donor spouse predeceased the donee spouse. The final regulations clarify that in cases where the donee spouse predeceases the donor spouse, the amount treated as a gift to the decedent/donee spouse on the creation of the tenancy is *not* treated as the donee spouse's contribution towards the acquisition of the property for purposes of section 2040(a). Thus, if the donee spouse provided no other consideration towards the acquisition of the property, no part of the property would be includible in the decedent/donee's gross estate under section 2040(a). No inference is intended as to the applicable rules in effect prior to the effective date of these regulations. Two additional examples have been added to further illustrate the application of the joint property rules.

J. Section 20.2056A–9 Designated Filer

In response to comments, the time period accorded the U.S. Trustee for submitting Schedule B, Form 706–QDT, to the Designated Filer has been increased from thirty to sixty days prior to the due date for filing the return. Also, in response to comments, the rule in the proposed regulations that the Designated Filer may allocate the section 2056A estate tax among the various QDOTs in the Designated Filer's discretion has been modified. The final regulations provide that the tax due from each QDOT is allocated on a pro rata basis (based on the ratio of the amount of the respective taxable events in each QDOT to the amount of all such taxable events), unless a different allocation is required in the governing instrument or under local law.

In response to comments suggesting that the regulations provide guidance in the event that the Designated Filer ceases to qualify as a U.S. Trustee, the final regulations provide that unless the decedent has provided for a successor Designated Filer, if the Designated Filer ceases to qualify as a U.S. Trustee or otherwise becomes unable to serve as the Designated Filer, the remaining trustees are required to select a qualifying successor Designated Filer (who is also a U.S. Trustee) prior to the due date for the filing of the next Form 706–QDT. Failure to select a successor Designated Filer will result in the application of section 2056A(b)(2)(C).

K. Section 20.2056A–11 Filing Requirements and Payment of Section 2056A Estate Tax

Comments were received suggesting that in the case of multiple QDOTs with respect to the same decedent, the extent of the trustees' liability for the amount of the section 2056A estate tax should be clarified. It was suggested that a trustee should be personally liable for the amount of any section 2056A estate tax imposed on any taxable event with respect to that trustee's trust, but should not be personally liable for tax imposed on the other trusts with respect to that decedent. In response to this comment, the trustee liability provisions of § 20.2056A–11(d) of the proposed regulations have been modified. In the case of multiple QDOTs with respect to the same decedent, each trustee of a QDOT is personally liable for the amount of the tax imposed on any taxable event with respect to that trustee's QDOT and a trustee is not personally liable for tax imposed with respect to taxable events involving QDOTs of which that person is not a trustee. However, the assets of a trust would be subject to collection for the section 2056A estate tax due with respect to any other trust with respect to that decedent.

L. Section 25.2523(i)–1 Disallowance of Gift Tax Marital Deduction When Spouse Is Not a United States Citizen

Comments were received concerning the conclusion in example 4 under § 25.2523(i)–1(d) of the proposed regulations. This example involves the transfer in trust to a noncitizen spouse with income payable to the spouse for life and remainder to the children of the donor. As proposed, the example concludes that the transfer is eligible for the $100,000 annual exclusion based on the rationale that if the donee were a citizen, the gift would qualify for a marital deduction if a qualified terminable interest property election were made. In response to the comments on this issue, the IRS has concluded that this result is not consistent with the statute because the gift does not qualify for the marital deduction ''but for'' the application of section 2523(i)(1). See section 2523(i)(2). The gift only qualifies for the marital deduction if an election is made under section 2523(f)(4) to treat the trust as qualified terminable interest property. This election is not available if the donee spouse is not a United States citizen. The statutory requirement that only gifts that would have qualified for the marital deduction but for section 2523(i) are eligible for the increased annual exclusion is intended to ensure that only gifts that would be includible in the spouse's gross estate at death (if the spouse were a United States citizen) qualify for the increased exclusion. This was not the case in the example as proposed and, as a result, the

conclusion in the example has been changed.

M. Section 25.2523(i)–2 Treatment of Spousal Joint Tenancy Property Where One Spouse Is Not a United States Citizen

Section 2523(i)(3) provides that the rules of section 2515 prior to repeal by the Economic Recovery Tax Act of 1981 shall generally apply if the donee spouse is not a United States citizen. The provision is effective for gifts made after July 14, 1988.

In response to comments, the final regulations under § 25.2523(i)–2(b) have been expanded to more fully describe the consequences of terminations of tenancies by the entirety and joint tenancies after July 13, 1988, where the donee spouse is not a United States citizen. As prescribed by statute, the gift tax consequences of the termination are governed by the principles of section 2515 (prior to repeal) and the regulations thereunder. Generally, under these rules, the gift tax consequences were dependent on whether or not the creation of the tenancy was initially treated as a gift under section 2515(a). Questions have been raised regarding the gift tax treatment for terminations of tenancies that were created after 1981 and before July 14, 1988. During this time period, section 2515 was not applicable and the generic principles of section 2511 governed the gift tax treatment of the creation of a joint tenancy or tenancy by the entirety. Accordingly, in response to these comments, the final regulations provide that, in the case of a termination on or after July 14, 1988, of a tenancy by the entirety or a joint tenancy that was created after 1981 and before July 14, 1988, if the creation of the tenancy was treated as a gift to the noncitizen donee spouse under section 2511 then, upon termination of the tenancy, the value of the property treated as a gift upon creation of the tenancy is treated as consideration originally belonging to the noncitizen spouse and never acquired by the noncitizen spouse from the donor spouse. With respect to the termination on or after July 14, 1988, of a tenancy by the entirety or joint tenancy created after 1954 and before 1982 (during which period section 2515 applied), the consequences of termination are determined under the rules of section 2515 and the regulations thereunder.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Susan B. Hurwitz, Office of Assistant Chief Counsel (Passthroughs and Special Industries), Internal Revenue Service. Other personnel from the IRS and Treasury Department participated in developing these regulations.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 20

Estate taxes, Reporting and recordkeeping requirements.

26 CFR Part 25

Gift taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR parts 1, 20, 25, and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C 7805 * * *

Par. 2. § 1.1015–5 is amended as follows:

a. The headings for paragraphs (a) and (b) are revised.

b. Paragraph (c) is redesignated as paragraph (d).

c. A new paragraph (c) is added.

The revisions and additions read as follows:

§ 1.1015–5 Increased basis for gift tax paid.

(a) *General rule in the case of gifts made on or before December 31, 1976.* * * *

* * * * *

(b) Amount of gift tax paid with respect to gifts made on or before December 31, 1976. * * *

* * * * *

(c) *Special rule for increased basis for gift tax paid in the case of gifts made after December 31, 1976*—(1) *In general.* With respect to gifts made after December 31, 1976 (other than gifts between spouses described in section 1015(e)), the increase in basis for gift tax paid is determined under section 1015(d)(6). Under section 1015(d)(6)(A), the increase in basis with respect to gift tax paid is limited to the amount (not in excess of the amount of gift tax paid) that bears the same ratio to the amount of gift tax paid as the net appreciation in value of the gift bears to the amount of the gift.

(2) *Amount of gift.* In general, for purposes of section 1015(d)(6)(A)(ii), the amount of the gift is determined in conformance with the provisions of paragraph (b) of this section. Thus, the amount of the gift is the amount included with respect to the gift in determining (for purposes of section 2503(a)) the total amount of gifts made during the calendar year (or calendar quarter in the case of a gift made on or before December 31, 1981), reduced by the amount of any annual exclusion allowable with respect to the gift under section 2503(b), and any deductions allowed with respect to the gift under section 2522 (relating to the charitable deduction) and section 2523 (relating to the marital deduction). Where more than one gift of a present interest in property is made to the same donee during a calendar year, the annual exclusion shall apply to the earliest of such gifts in point of time.

(3) *Amount of gift tax paid with respect to the gift.* In general, for purposes of section 1015(d)(6), the amount of gift tax paid with respect to the gift is determined in conformance with the provisions of paragraph (b) of this section. Where more than one gift is made by the donor in a calendar year (or quarter in the case of gifts made on or before December 31, 1981), the amount of gift tax paid with respect to any specific gift made during that period is the amount which bears the same ratio to the total gift tax paid for that period (determined after reduction for any gift tax unified credit available under section 2505) as the amount of the gift (computed as described in paragraph (c)(2) of this section) bears to the total taxable gifts for the period.

(4) *Qualified domestic trusts.* For purposes of section 1015(d)(6), in the case of a qualified domestic trust (QDOT) described in section 2056A(a),

any distribution during the noncitizen surviving spouse's lifetime with respect to which a tax is imposed under section 2056A(b)(1)(A) is treated as a transfer by gift, and any estate tax paid on the distribution under section 2056A(b)(1)(A) is treated as a gift tax. The rules under this paragraph apply in determining the extent to which the basis in the assets distributed is increased by the tax imposed under section 2056A(b)(1)(A).

(5) *Examples.* Application of the provisions of this paragraph (c) may be illustrated by the following examples:

Example 1. (i) Prior to 1995, *X* exhausts *X*'s gift tax unified credit available under section 2505. In 1995, *X* makes a gift to *X*'s child *Y*, of a parcel of real estate having a fair market value of $100,000. *X*'s adjusted basis in the real estate immediately before making the gift was $70,000. Also in 1995, *X* makes a gift to *X*'s child *Z*, of a painting having a fair market value of $70,000. *X* timely files a gift tax return for 1995 and pays gift tax in the amount of $55,500, computed as follows:

Value of real estate transferred to *Y*	$100,000	
Less: Annual exclusion	10,000	
Included amount of gift (C)		$90,000
Value of painting transferred to *Z*	$70,000	
Less: annual exclusion	10,000	
Included amount of gift		60,000
Total included gifts (D)		$150,000
Total gift tax liability for 1995 gifts (B)		$55,500

(ii) The gift tax paid with respect to the real estate transferred to *Y*, is determined as follows:

$$\frac{\$90{,}000\ (C)}{\$150{,}000\ (D)} \times \$55{,}500\ (B) = \$33{,}300$$

(iii) (A) The amount by which *Y*'s basis in the real property is increased is determined as follows:

$$\frac{\$30{,}000\ (\text{net appreciation})}{\$90{,}000\ (\text{amount of gift})} \times \$33{,}300 = \$11{,}100$$

(B) *Y*'s basis in the real property is $70,000 plus $11,100, or $81,100. If × had not exhausted any of *X*'s unified credit, no gift tax would have been paid and, as a result, *Y*'s basis would not be increased.

Example 2. (i) *X* dies in 1995. *X*'s spouse, *Y*, is not a United States citizen. In order to obtain the marital deduction for property passing to *X*'s spouse, *X* established a QDOT in *X*'s will. In 1996, the trustee of the QDOT makes a distribution of principal from the QDOT in the form of shares of stock having a fair market value of $70,000 on the date of distribution. The trustee's basis in the stock (determined under section 1014) is $50,000. An estate tax is imposed on the distribution under section 2056A(b)(1)(A) in the amount $38,500, and is paid. *Y*'s basis in the shares of stock is increased by a portion of the section 2056A estate tax paid determined as follows:

$$\frac{\$20{,}000\ (\text{net appreciation})}{\$70{,}000\ (\text{distribution})} \times \$38{,}500\ (\text{section 2056A estate tax}) = \$11{,}000$$

(ii) *Y*'s basis in the stock is $50,000 plus $11,000, or $61,000.

(6) *Effective date.* The provisions of this paragraph (c) are effective for gifts made after August 22, 1995.

* * * * *

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 3. The authority citation for part 20 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 4. In § 20.2056–0, the table of contents is amended by:

a. Redesignating the entries for §§ 20.2056(d)–1 and 20.2056(d)–2 as §§ 20.2056(d)–2 and 20.2056(d)–3, respectively.

b. Adding a new entry for § 20.2056(d)–1 to read as follows:

§ 20.2056–0 Table of contents

* * * * *

§ 20.2056(d)–1 Marital deduction; special rules for marital deduction if surviving spouse is not a United States citizen.

* * * * *

Par. 5. Sections 20.2056(d)–1 and 20.2056(d)–2 are redesignated as §§ 20.2056(d)–2 and 20.2056(d)–3, respectively, and new § 20.2056(d)–1 is added to read as follows:

§ 20.2056(d)–1 Marital deduction; special rules for marital deduction if surviving spouse is not a United States citizen.

Rules pertaining to the application of section 2056(d), including certain transition rules, are contained in §§ 20.2056A–1 through 20.2056A–13.

Par. 6. Sections 20.2056A–0 through 20.2056A–13 are added to read as follows:

§ 20.2056A–0 Table of contents.

This section lists the captions that appear in the final regulations under §§ 20.2056A–1 through 20.2056A–13.

§ 20.2056A–1 Restrictions on allowance of marital deduction if surviving spouse is not a United States citizen.

(a) General rule.

(b) Marital deduction allowed if resident spouse becomes citizen.

(c) Special rules in the case of certain transfers subject to estate and gift tax treaties.

§ 20.2056A–2 Requirements for qualified domestic trust.

(a) In general.

(b) Qualified marital interest requirements.

(1) Property passing to QDOT.

(2) Property passing outright to spouse.

(3) Property passing under a nontransferable plan or arrangement.

(c) Statutory requirements.

(d) [Reserved]

§ 20.2056A–3 QDOT election.

(a) General rule.

(b) No partial elections.

(c) Protective elections.

(d) Manner of election.

§ 20.2056A–4 Procedures for conforming marital trusts and nontrust marital transfers to the requirements of a qualified domestic trust.

(a) Marital trusts.

(1) In general.

(2) Judicial reformations.

(3) Tolling of statutory assessment period.

(b) Nontrust marital transfers.

(1) In general.

§ 20.2056A–1 Restrictions on allowance of marital deduction if surviving spouse is not a United States citizen.

(a) *General rule.* Subject to the special rules provided in section 7815(d)(14) of the Omnibus Budget Reconciliation Act of 1989 (Pub. L. 101–239; 103 Stat. 2106), in the case of a decedent dying after November 10, 1988, the federal estate tax marital deduction is not allowed for property passing to or for the benefit of a surviving spouse who is not a United States citizen at the date of the decedent's death (whether or not the surviving spouse is a resident of the United States) unless—

(1) The property passes from the decedent to (or pursuant to)—

(i) A qualified domestic trust (QDOT) described in section 2056A and § 20.2056A–2;

(ii) A trust that, although not meeting all of the requirements for a QDOT, is reformed after the decedent's death to meet the requirements of a QDOT (see § 20.2056A–4(a));

(iii) The surviving spouse not in trust (e.g., by outright bequest or devise, by operation of law, or pursuant to the terms of an annuity or other similar plan or arrangement) and, prior to the date that the estate tax return is filed and on or before the last date prescribed by law that the QDOT election may be made (no more than one year after the time prescribed by law, including extensions, for filing the return), the surviving spouse either actually transfers the property to a QDOT or irrevocably assigns the property to a QDOT (see § 20.2056A–4(b)); or

(iv) A plan or other arrangement that would have qualified for the marital deduction but for section 2056(d)(1)(A), and whose payments are not assignable or transferable to a QDOT, if the requirements of § 20.2056A–4(c) are met; and

(2) The executor makes a timely QDOT election under § 20.2056A–3.

(b) *Marital deduction allowed if resident spouse becomes citizen.* For purposes of section 2056(d)(1) and paragraph (a) of this section, the surviving spouse is treated as a citizen of the United States at the date of the decedent's death if the requirements of section 2056(d)(4) are satisfied. For purposes of section 2056(d)(4)(A) and notwithstanding § 20.2056A–3(a), a return filed prior to the due date (including extensions) is considered filed on the last date that the return is required to be filed (including extensions), and a late return filed at any time after the due date is considered filed on the date that it is actually filed. A surviving spouse is a resident only if the spouse is a resident under chapter 11 of the Internal Revenue Code. See § 20.0–1(b)(1). The status of the spouse as a resident under section 7701(b) is not relevant to this determination except to the extent that the income tax residency of the spouse is pertinent in applying § 20.0–1(b)(1).

(c) *Special rules in the case of certain transfers subject to estate and gift tax treaties.* Under section 7815(d)(14) of the Omnibus Budget Reconciliation Act of 1989 (Pub. L. 101–239, 103 Stat. 2106) certain special rules apply in the case of transfers governed by certain estate and gift tax treaties to which the United States is a party. In the case of the estate of, or gift by, an individual who was not a citizen or resident of the United States but was a resident of a foreign country with which the United States has a tax treaty with respect to estate, inheritance, or gift taxes, the amendments made by section 5033 of the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100–647, 102 Stat. 3342) do not apply to the extent such amendments would be inconsistent with the provisions of such treaty relating to estate, inheritance, or gift tax marital deductions. Under this rule, the estate may choose either the statutory deduction under section 2056A or the marital deduction allowed under the treaty. Thus, the estate may not avail itself of both the marital deduction under the treaty and the marital deduction under the QDOT provisions of section 2056A and chapter 11 of the Internal Revenue Code with respect to the remainder of the marital property that is not deductible under the treaty.

§ 20.2056A–2 Requirements for qualified domestic trust.

(a) *In general.* In order to qualify as a qualified domestic trust (QDOT), the requirements of paragraphs (b) and (c) of this section, and the requirements of § 20.2056A–2T(d), must be satisfied. The executor of the decedent's estate and the U.S. Trustee shall establish in such manner as may be prescribed by the Commissioner on the estate tax return and applicable instructions that these requirements have been satisfied or are being complied with. In order to constitute a QDOT, the trust must be maintained under the laws of a state of the United States or the District of Columbia, and the administration of the trust must be governed by the laws of a particular state of the United States or the District of Columbia. For purposes of this paragraph (a), a trust is maintained under the laws of a state of the United States or the District of Columbia if the records of the trust (or copies thereof) are kept in that state (or the District of Columbia). The trust may be established pursuant to an instrument executed under either the laws of a state of the United States or the District of Columbia or pursuant to an instrument executed under the laws of a foreign jurisdiction, such as a foreign will or trust, provided that such foreign instrument designates the law of a particular state of the United States or the District of Columbia as governing the administration of the trust, and such designation is effective under the law of the designated jurisdiction. In addition, the trust must constitute an ordinary trust, as defined in § 301.7701–4(a) of this chapter, and not any other type of entity. For purposes of this paragraph, a trust will not fail to constitute an ordinary trust solely because of the nature of the assets transferred to that trust, regardless of its classification under §§ 301.7701–2 through 301.7701–4 of this chapter.

(b) *Qualified marital interest requirements*—(1) *Property passing to QDOT.* If property passes from a decedent to a QDOT, the trust must qualify for the federal estate tax marital deduction under section 2056(b)(5) (life estate with power of appointment), section 2056(b)(7) (qualified terminable interest property, including joint and survivor annuities under section 2056(b)(7)(C)), or section 2056(b)(8) (surviving spouse is the only noncharitable beneficiary of a charitable remainder trust), or meet the requirements of an estate trust as defined in § 20.2056(c)–2(b)(1)(i) through (iii).

(2) *Property passing outright to spouse.* If property does not pass from a decedent to a QDOT, but passes to a noncitizen surviving spouse in a form that meets the requirements for a marital deduction without regard to section 2056(d)(1)(A), and that is not described in paragraph (b)(1) of this section, the surviving spouse must either actually transfer the property, or irrevocably assign the property, to a trust (whether created by the decedent, the decedent's executor or by the surviving spouse) that meets the requirements of paragraph (c) of this section and the requirements of § 20.2056A–2T(d) (pertaining, respectively, to statutory requirements and regulatory requirements imposed to ensure collection of tax) prior to the filing of the estate tax return for the decedent's estate and on or before the last date prescribed by law that the QDOT election may be made (see § 20.2056A–3(a)).

(3) *Property passing under a nontransferable plan or arrangement.* If property does not pass from a decedent to a QDOT, but passes under a plan or other arrangement that meets the requirements for a marital deduction without regard to section 2056(d)(1)(A) and whose payments are not assignable or transferable (see § 20.2056A–4(c)), the property is treated as meeting the requirements of this section, and the requirements of § 20.2056A–2T(d), if the requirements of § 20.2056A–4(c) are satisfied. In addition, where an annuity or similar arrangement is described above except that it is assignable or transferable, see § 20.2056A–4(b)(7).

(c) *Statutory requirements.* The requirements of section 2056A(a)(1)(A) and (B) must be satisfied. For purposes of that section, a domestic corporation is a corporation that is created or organized under the laws of the United States or under the laws of any state of the United States or the District of Columbia. The trustee required under that section is referred to herein as the ''U.S. Trustee''.

(d) [Reserved]

§ 20.2056A–3 QDOT election.

(a) *General rule.* Subject to the time period prescribed in section 2056A(d), the election to treat a trust as a QDOT must be made on the last federal estate tax return filed before the due date (including extensions of time to file actually granted) or, if a timely return is not filed, on the first federal estate tax return filed after the due date. The election, once made, is irrevocable.

(b) *No partial elections.* An election to treat a trust as a QDOT may not be made with respect to a specific portion of an entire trust that would otherwise qualify for the marital deduction but for the application of section 2056(d). However, if the trust is actually severed in accordance with the applicable requirements of § 20.2056(b)–7(b)(2)(ii) prior to the due date for the election, a QDOT election may be made for any one or more of the severed trusts.

(c) *Protective elections.* A protective election may be made to treat a trust as a QDOT only if at the time the federal estate tax return is filed, the executor of the decedent's estate reasonably believes that there is a bona fide issue that concerns either the residency or citizenship of the decedent, the citizenship of the surviving spouse, whether an asset is includible in the decedent's gross estate, or the amount or nature of the property the surviving spouse is entitled to receive. For example, if at the time the federal estate tax return is filed either the estate is involved in a bona fide will contest, there is uncertainty regarding the inclusion in the gross estate of an asset which, if includible, would be eligible for the QDOT election, or there is uncertainty regarding the status of the decedent as a resident alien or a nonresident alien for estate tax purposes, or a similar uncertainty regarding the citizenship status of the surviving spouse, a protective QDOT election may be made. The protective election is in addition to, and is not in lieu of, the requirements set forth in § 20.2056A–4. The protective QDOT election must be made on a written statement signed by the executor under penalties of perjury and must be attached to the return described in paragraph (a) of this section, and must identify the specific assets to which the protective election refers and the specific basis for the protective election. However, the protective election may otherwise be defined by means of a formula (such as the minimum amount necessary to reduce the estate tax to zero). Once made, the protective election is irrevocable. For example, if a protective election is made because a bona fide question exists as to the includibility of an asset in the decedent's gross estate and it is later finally determined that the asset is so includible, the protective election becomes effective with respect to the asset and cannot thereafter be revoked.

(d) *Manner of election.* The QDOT election under paragraph (a) of this section is made in the form and manner set forth in the decedent's estate tax return, including applicable instructions.

§ 20.2056A–4 Procedures for conforming marital trusts and nontrust marital transfers to the requirements of a qualified domestic trust.

(a) *Marital trusts*—(1) *In general.* If an interest in property passes from the decedent to a trust for the benefit of a noncitizen surviving spouse and if the trust otherwise qualifies for a marital deduction but for the provisions of section 2056(d)(1)(A), the property interest is treated as passing to the surviving spouse in a QDOT if the trust is reformed, either in accordance with the terms of the decedent's will or trust agreement or pursuant to a judicial proceeding, to meet the requirements of a QDOT. For this purpose, the requirements of a QDOT include all of the applicable requirements set forth in § 20.2056A–2, and the requirements of § 20.2056A–2T(d). A reformation pursuant to the terms of the decedent's will or trust instrument must be completed by the time prescribed (including extensions) for filing the decedent's estate tax return. For purposes of this paragraph (a), a return filed prior to the due date (including extensions) is considered filed on the last date that the return is required to be filed (including extensions), and a late return filed at any time after the due date is considered filed on the date that it is actually filed.

(2) *Judicial reformations.* In general, a reformation pursuant to a judicial proceeding is permitted under this section if the reformation is commenced on or before the due date (determined with regard to extensions actually granted) for filing the return of tax imposed by chapter 11 of the Internal Revenue Code, regardless of the date that the return is actually filed. The reformation (either pursuant to a judicial proceeding or otherwise) must result in a trust that is effective under local law. The reformed trust may be revocable by the spouse, or otherwise be subject to the spouse's general power of appointment, provided that no person (including the spouse) has the power to amend the trust during the continued existence of the trust such that it would no longer qualify as a QDOT. Prior to the time that the judicial reformation is completed, the trust must be treated as a QDOT. Thus, the trustee of the trust is responsible for filing the Form 706–QDT, paying any section 2056A estate tax that becomes due, and filing the annual statement required under § 20.2056A–2T(d)(3), if applicable. Failure to comply with these requirements may cause the trust to be subject to the anti-abuse rule under § 20.2056A–2T(d)(1)(iv). In addition, if the judicial reformation is terminated prior to the time that the reformation is completed, the estate of the decedent is required to pay the increased estate tax imposed on the decedent's estate (plus interest and any applicable penalties) that becomes due at the time of such termination as a result of the failure of the trust to comply with section 2056(d). See section 6511 as to applicable time periods for credit or refund of tax.

(3) *Tolling of statutory assessment period.* For the tolling of the statute of limitations in the case of a judicial reformation, see section 2056(d)(5)(B).

(b) *Nontrust marital transfers*—(1) *In general.* Under section 2056(d)(2)(B), if an interest in property passes outright from a decedent to a noncitizen surviving spouse either by testamentary bequest or devise, by operation of law, or pursuant to an annuity or other similar plan or arrangement, and such property interest otherwise qualifies for a marital deduction except that it does not pass in a QDOT, solely for purposes of section 2056(d)(2)(A), the property is treated as passing to the surviving spouse in a QDOT if the property interest is either actually transferred to a QDOT before the estate tax return is filed and on or before the last date prescribed by law that the QDOT election may be made, or is assigned to a QDOT under an enforceable and irrevocable written assignment made on or before the date on which the return is filed and on or before the last date prescribed by law that the QDOT election may be made. The transfer or assignment of property to a QDOT may be made by the surviving spouse, the surviving spouse's legal representative (if the surviving spouse is incompetent), or the personal representative of the surviving spouse's estate (if the surviving spouse has died). The QDOT to which the property is transferred may be created by the decedent (during life or by will), by the surviving spouse, or by the executor. For purposes of section 2056(d)(2)(B), if no property other than the property passing to the surviving spouse from the decedent is transferred to the QDOT, the transferee QDOT need not be in a form such that the property transferred to the QDOT would qualify for a marital deduction under section 2056(a). However, if other property is or has been transferred to the QDOT, 100 percent of the value of the transferee QDOT must qualify for the marital deduction under section 2056. For example, if the decedent, a U.S. citizen, bequeaths property to a trust that does not satisfy the requirements of section 2056(b)(5) or (7), or to a trust that does not qualify as an estate trust under § 20.2056(c)–2(b)(1)(i)–(iii), that trust cannot be used as a transferee QDOT by the surviving spouse, since after that trust is fully funded the portion of the value of the trust attributable to property bequeathed to the trust by the decedent will not qualify for a marital deduction under section 2056. Similarly, if the decedent, a nonresident not a citizen of the United States, bequeaths foreign situs assets to a trust created under his will, the surviving spouse may not transfer U.S. situs assets passing to the spouse outside of the will to that trust under this paragraph. See § 20.2056A–3(c) with respect to protective elections. See § 20.2056A–3(a) with respect to the time limitations for making the QDOT election.

(2) *Form of transfer or assignment.* A transfer or assignment of property to a QDOT must be in writing and otherwise be in accordance with all local law requirements for such assignment or transfer. The transfer or assignment may be of a specific asset or a group of assets, or a fractional share of either, or may be of a pecuniary amount. A transfer or assignment of less than an entire interest in an asset or a group of assets may be expressed by means of a formula (such as the minimum amount necessary to reduce the estate tax to zero). In the case of a transfer, a copy of the trust instrument evidencing the transfer must be submitted with the decedent's estate tax return. In the case of an assignment, a copy of the assignment must be submitted with the decedent's estate tax return.

(3) *Assets eligible for transfer or assignment.* If a transfer or assignment is of a specific asset or group of assets, only assets included in the decedent's gross estate and passing from the decedent to the spouse (or the proceeds from the sale, exchange or conversion of such assets) may be transferred or assigned to the QDOT. The noncitizen surviving spouse may not transfer or assign to the QDOT property owned by the surviving spouse at the time of the decedent's death in lieu of property included in the decedent's gross estate that passes to the spouse (or in lieu of the proceeds from the sale, exchange or conversion of such includible assets). In addition, if only a portion of an asset is includible in the decedent's gross estate, the spouse may only transfer the portion that is so includible to the transferee trust under this paragraph (b)(3).

(4) *Pecuniary assignment—special rules.* If the assignment is expressed in the form of a pecuniary amount (such as a fixed dollar amount or a formula designed to reduce the decedent's estate tax to zero), the assignment must specify that—

(i) Assets actually transferred to the QDOT in satisfaction of the assignment have an aggregate fair market value on the date of actual transfer to the QDOT amounting to no less than the amount of the pecuniary transfer or assignment; or

(ii) The assets actually transferred to the QDOT be fairly representative of appreciation or depreciation in the value of all property available for transfer to the QDOT between the valuation date and the date of actual transfer to the QDOT, if the assignment is to be satisfied by accounting for the assets on the basis of their fair market value as of some date before the date of actual transfer to the QDOT.

(5) *Transfer tax treatment of transfer or assignment.* Property assigned or transferred to a QDOT pursuant to section 2056(d)(2)(B) is treated as passing from the decedent to a QDOT solely for purposes of section 2056(d)(2)(A). For all other purposes (e.g., income, gift, estate, generation-skipping transfer tax, and section 1491 excise tax), the surviving spouse is treated as the transferor of the property to the QDOT. However, the spouse is not considered the transferor of property to a QDOT if the transfer by the spouse constitutes a transfer that satisfies the requirements of section 2518(c)(3). For a special exception to the valuation rules of section 2702 in the case of a transfer by the surviving spouse to a QDOT, see § 25.2702–1(c)(8) of this chapter.

(6) *Period for completion of transfer.* Property irrevocably assigned but not actually transferred to the QDOT before the estate tax return is filed must actually be conveyed and transferred to the QDOT under applicable local law before the administration of the decedent's estate is completed. If there is no administration of the decedent's estate (because for example, none of the decedent's assets are subject to probate under local law), the conveyance must be made on or before the date that is one year after the due date (including extensions) for filing the decedent's estate tax return. If an actual transfer to the QDOT is not timely made, section 2056(d)(1)(A) applies and the marital deduction is not allowed. The executor of the decedent's estate (or other authorized legal representative) may request a private letter ruling from the Internal Revenue Service requesting an extension of the time for completing the conveyance or waiving the actual conveyance under specified circumstances under § 301.9100–1(a) of this chapter.

(7) *Retirement accounts and annuities*—(i) *In general.* An assignment otherwise in compliance with this paragraph (b) of rights under annuities or other similar arrangements that are assignable and thus, are not described in paragraph (c) of this section, is treated as a transfer of such property to the QDOT regardless of the method of payment actually elected under such annuity or plan.

(ii) *Individual retirement annuities.* Individual retirement annuities described in section 408(b) are not assignable pursuant to section 408(b)(1) and thus, do not come within the purview of this paragraph (b)(7). See the procedures provided in paragraph (c) of this section.

(iii) *Individual retirement accounts.* Unless the terms of the account provide otherwise, individual retirement accounts described in section 408(a) are assignable and subject to the provisions of this paragraph (b)(7). However, under paragraph (c) of this section, the surviving spouse may treat an individual retirement account as nonassignable and, therefore, eligible for the procedures in paragraph (c) of this section if the spouse timely complies with the requirements in paragraph (c) of this section.

(iv) *Other effects of assignment.* The provisions of this paragraph (b)(7) apply solely for purposes of qualifying the annuity or account under the rules of § 20.2056A–2 and this section. See, for example, section 408(d) and 4980A regarding the consequences of an assignment for purposes other than this paragraph (b)(7).

(8) *Protective assignment.* A protective assignment of property to a QDOT may be made only if, at the time the federal estate tax return is filed, the executor of the decedent's estate reasonably believes that there is a bona fide issue that concerns either the residency or citizenship of the decedent, the citizenship of the surviving spouse, whether all or a portion of an asset is includible in the decedent's gross estate, or the amount or nature of the property the surviving spouse is entitled to receive. For example, if at the time the federal estate tax return is filed, either the estate is involved in a bona fide will contest, there is uncertainty regarding the inclusion in the gross estate of an asset which, if includible, would be eligible for the QDOT election, or there is uncertainty regarding the status of the decedent as a resident alien or a nonresident alien for estate tax purposes, or a similar uncertainty regarding the citizenship status of the surviving spouse, a protective assignment may be made. The protective assignment must be made on a written statement signed by the assignor under penalties of perjury on or before the date prescribed under paragraph (b)(1) of this section, and must identify the specific assets to which the assignment refers and the specific basis for the protective assignment. However, the protective assignment may otherwise be defined by means of a formula (such as the minimum amount necessary to reduce the estate tax to zero). Once made, the protective assignment cannot be revoked. For example, if a protective assignment is made because a bona fide question exists as to the includibility of an asset in the decedent's gross estate and it is later finally determined that the asset is so includible, the protective assignment becomes effective with respect to the asset and cannot thereafter be revoked. Protective assignments are, in all events, subject to paragraph (b)(6) of this section. A copy of the protective assignment must be submitted with the decedent's estate tax return.

(c) *Nonassignable annuities and other arrangements*—(1) *Definition and general rule.* For purposes of this section, a *nonassignable annuity or other arrangement* means a plan, annuity, or other arrangement (whether qualified or not qualified under part I of subchapter D of chapter 1 of subtitle A of the Internal Revenue Code) that qualifies for the marital deduction but for section 2056(d)(1)(A), and whose payments are not assignable or transferable to the QDOT under either federal law (see, e.g., section 401(a)(13)), state law, foreign law, or the terms of the plan or arrangement itself. For purposes of this paragraph (c), a surviving spouse's interest as beneficiary of an individual retirement annuity described in section 408(b) is a nonassignable annuity or other arrangement. See section 408(b)(1). For purposes of this paragraph (c), a surviving spouse's interest as beneficiary of an individual retirement account described in section 408(a), although assignable under that section, is considered to be a nonassignable annuity or other arrangement eligible for the procedures contained in this paragraph (c), at the option of the surviving spouse, if the requirements of this paragraph are otherwise satisfied. See paragraph (b)(7) of this section if the spouse elects to treat the account as assignable. In the case of a plan, annuity, or other arrangement which is not assignable or transferable (or is treated as such), the property passing under the plan from the decedent is treated as meeting the requirements § 20.2056A–2, and the requirements of § 20.2056A–2T(d) (pertaining,

respectively, to general requirements, qualified marital interest requirements, statutory requirements, and requirements to ensure collection of the tax) if the requirements of either paragraph (c)(2) or (3) of this section are satisfied. Thus, the property will be treated as passing in the form of a QDOT, notwithstanding that the spouse does not irrevocably transfer or assign the annuity or other payment to the QDOT as provided in paragraph (b) of this section. The Commissioner will prescribe by administrative guidance the extent, if any, to which the provisions of this paragraph (c) apply to a rollover from a qualified trust to an eligible retirement plan within the meaning of section 402(c) or a distribution from an individual retirement account or an individual retirement annuity that is paid into an individual retirement account or an individual retirement annuity within the meaning of section 408(d)(3).

(2) *Agreement to remit section 2056A estate tax on corpus portion of each annuity payment.* The requirements of this paragraph (c)(2) are satisfied if—

(i) The noncitizen surviving spouse agrees to pay on an annual basis, as described in paragraph (c)(6)(i) of this section, the estate tax imposed under section 2056A(b)(1) due on the corpus portion, as defined in paragraph (c)(4) of this section, of each nonassignable annuity or other payment received under the plan or arrangement. However, for purposes of this paragraph (c)(2), if the financial circumstances of the spouse are such that an amount equal to all or a portion of the corpus portion of a nonassignable annuity payment received by the spouse would be subject to a hardship exemption (as defined in § 20.2056A–5(c)) if paid from a QDOT, then all or a corresponding part of the corpus portion will be exempt from the tax payment requirement under this paragraph (c)(2);

(ii) The executor of the decedent's estate files with the estate tax return the Information Statement described in paragraph (c)(5) of this section;

(iii) The executor files with the estate tax return the Agreement To Pay Section 2056A Estate Tax described in paragraph (c)(6) of this section; and

(iv) The executor makes the election under § 20.2056A–3 with respect to the nonassignable annuity or other payment.

(3) *Agreement to roll over corpus portion of annuity payment to QDOT.* The requirements of this paragraph (c)(3) are satisfied if—

(i) The noncitizen surviving spouse agrees to roll over and transfer, within the time prescribed under paragraph (c)(7)(i) of this section, the corpus portion of each annuity payment to a QDOT, whether the QDOT is created by the decedent's will, the executor of the decedent's estate, or the surviving spouse. However, for purposes of this section, if the financial circumstances of the spouse are such that an amount equal to all or a portion of the corpus portion of a nonassignable annuity payment received by the spouse would be subject to a hardship exemption (as defined in § 20.2056A–5(c)) if paid from a QDOT, then all or a corresponding part of the corpus portion will be exempt from the rollover requirement under this paragraph (c)(3);

(ii) A QDOT for the benefit of the surviving spouse is established prior to the date that the estate tax return is filed and on or prior to the last date prescribed by law that the QDOT election may be made;

(iii) The executor of the decedent's estate files with the estate tax return the Information Statement described in paragraph (c)(5) of this section;

(iv) The executor files with the estate tax return the Agreement To Roll Over Annuity Payments described in paragraph (c)(7) of this section; and

(v) The executor makes the election under § 20.2056A–3 with respect to the nonassignable annuity or other payment. See § 20.2056A–5(c)(3)(iv)(A), regarding distributions from the QDOT reimbursing the spouse for income taxes paid (either by actual payment or withholding) by the spouse with respect to amounts transferred to the QDOT pursuant to this paragraph (c)(3).

(4) *Determination of corpus portion*—(i) *Corpus portion.* For purposes of this paragraph (c), the corpus portion of each nonassignable annuity or other payment is the corpus amount of the annual payment divided by the total annual payment.

(ii) *Corpus amount.* (A) The corpus amount of the annual payment is determined in accordance with the following formula:

$$\text{Corpus Amount} = \frac{\text{Total present value of annuity or other payment}}{\text{Expected annuity term}}$$

(B) The total present value of the annuity or other payment is the present value of the nonassignable annuity or other payment as of the date of the decedent's death, determined in accordance with the interest rates and mortality data prescribed by section 7520. The expected annuity term is the number of years that would be required for the scheduled payments to exhaust a hypothetical fund equal to the present value of the scheduled payments. This is determined by first dividing the total present value of the payments by the annual payment. From the quotient so obtained, the expected annuity term is derived by identifying the term of years that corresponds to the annuity factor equal to the quotient. This is determined by using column 1 of Table B, for the applicable interest rate, contained in Publication 1457, *Alpha Volume*. A copy of this publication may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402. If the quotient obtained falls between two terms, the longer term is used.

(5) *Information Statement*—(i) *In general.* In order for a nonassignable annuity or other payment described in this paragraph (c) to qualify under either paragraph (c) (2) or (3) of this section, the Information Statement described in paragraph (c)(5)(ii) of this section must be filed with the decedent's federal estate tax return. The Information Statement must be signed under penalties of perjury by both the executor of the decedent's estate and by the surviving spouse of the decedent (or by the legal representative of the surviving spouse if the surviving spouse is legally incompetent to sign the statement). The Statement must contain all of the information prescribed by this paragraph (c)(5).

(ii) *Annuity source information*—(A) *Employment-related annuity.* If the nonassignable annuity or other payment is employment-related, the following information must be provided—

(*1*) The name and address of the employer;

(*2*) The date of retirement or other separation from employment of the decedent;

(*3*) The name and address of the pension fund, insurance company, or other obligor that is paying the annuity (or similar payment); and

(*4*) The identification number, if any, that the obligor has assigned to the annuity or other payment.

(B) *Annuity not employment-related.* If the nonassignable annuity or other payment is not employment-related, the following information must be provided—

(*1*) The name and address of the person or entity paying the nonassignable annuity or other payment;

(*2*) The date of acquisition of the nonassignable annuity contract by the decedent or by the decedent and the surviving spouse; and

(*3*) The identification number, if any, that the obligor has assigned to the nonassignable annuity or other payment.

(iii) *The total annuity amount payable each year.* The total amount payable annually under the nonassignable annuity or other arrangement, including a description of whether the annuity is payable monthly, quarterly, or at some other interval, and a description of any scheduled changes in the annuity payout amount.

(iv) *The duration of the annuity.* A description of the term of the nonassignable annuity or other payment in years, if it is determined by a term certain, and the name, address, and birthdate of any measuring life if the nonassignable annuity or other payment is determined by one or more lives.

(v) *The market interest rate under section 7520.* The applicable interest rate as determined under section 7520.

(vi) *Determination of corpus portion of each payment (in accordance with paragraph (c)(4) of this section).* The following items are required in order to determine the corpus portion of each payment—

(A) The present value of the nonassignable annuity or other payment as of the decedent's death;

(B) The expected annuity term;

(C) The corpus amount of the annual annuity payments (paragraph (c)(5)(vi)(A) of this section divided by paragraph (c)(5)(vi)(B) of this section); and

(D) The corpus portion of the annual payments (paragraph (c)(5)(vi)(C) of this section divided by the total amount payable annually).

(vii) *Recipient QDOT.* In the case of an agreement to rollover under paragraph (c)(3) of this section, the following must be provided—

(A) The name and address of the trustee of the QDOT who is the U.S. Trustee; and

(B) The name and taxpayer identification number of the QDOT.

(viii) *Certification statement.* The executor of the decedent's estate and the surviving spouse of the decedent (or the legal representative of the surviving spouse if the surviving spouse is legally incompetent to so certify) must each sign a Certification Statement as follows:

Under penalties of perjury, I hereby certify that, to the best of my knowledge and belief, the information reported in this Information Statement is true, correct and complete.

(6) *Agreement to pay section 2056A estate tax—(i) Payment of section 2056A estate tax.* The tax payable under paragraph (c)(2) of this section is payable on an annual basis, commencing in the calendar year following the calendar year of the receipt by the surviving spouse of the spouse's first annuity payment. Form 706QDT and the payment are due on April 15th of each year following the calendar year in which an annuity payment is received except that, in the year of the deceased spouse's death, the Form 706–QDT and the payment are not due prior to the due date, including extensions, for filing the deceased spouse's estate tax return, or if no return is filed, no later than 9 months from the date of the deceased spouse's death; and, in the year of the surviving spouse's death, the Form 706–QDT must be filed and the payment made no later than 9 months from the date of the surviving spouse's death. See § 20.2056A–11 for extensions of time for filing Form 706–QDT and paying the section 2056A estate tax.

(ii) *Agreement.* In order for a nonassignable annuity or other payment described in this paragraph (c) to qualify under paragraph (c)(2) of this section, the executor of the decedent's estate must file with the estate tax return the following Agreement To Pay Section 2056A Estate Tax, which must be signed by the surviving spouse of the decedent (or by the surviving spouse's legal representative if the surviving spouse is legally incompetent to sign the agreement):

I [*name*] hereby agree that I will report all annuity payments received under the [*name of plan or arrangement*] on Form 706–QDT for the calendar year and remit, on an annual basis, to the Internal Revenue Service the estate tax that is imposed under section 2056A(b)(1) of the Internal Revenue Code on the corpus portion of each annuity payment (as defined in § 20.2056A–4(c)(4) of the Estate Tax Regulations) received under the plan during the calendar year. I also agree that Form 706–QDT is to be filed no later than April 15th of the year following the calendar year in which any annuity payments are received except that: in the case of annuity payments received in the year of my spouse's death, Form 706–QDT and the payment shall not be due prior to the due date, including extensions, for filing my spouse's estate tax return or, if no return is filed, no later than 9 months from the date of my spouse's death (except if I am granted an extension of time to file Form 706–QDT under the provisions of § 20.2056A–11); and in the year of my death, the Form 706–QDT must be filed and the payment made no later than the date my estate tax return is filed (or if no return is filed, no later than 9 months from the date of my death). I further agree that if I fail to timely file Form 706–QDT or to timely pay the tax imposed on the corpus portion of any annuity payment (determined after any extensions of time to pay granted to me under the provisions of § 20.2056A-11), I may become immediately liable to pay the amount of the tax determined by application of section 2056A(b)(1) on the entire remaining present value of the annuity, calculated as of the beginning of the year in which the payment was received with respect to which I failed to timely pay the tax or failed to timely file the return. However, I may make an application for relief under § 301.9100–1 of the Procedure and Administration Regulations, from the consequences of failing to timely file the Form 706–QDT or failing to timely pay the tax on the corpus portion. [The following sentence is applicable only in cases where the plan or arrangement is established and administered by a person or an entity that is located outside of the United States.] I agree, at the request of the District Director, [or the Assistant Commissioner (International) in the case of a surviving spouse of a nonresident noncitizen decedent or a surviving spouse of a United States citizen who died domiciled outside the United States] to enter into a security agreement to secure my undertakings under this agreement.

(7) *Agreement to roll over annuity payments*—(i) *Roll over of corpus portion.* Beginning in the calendar year of the receipt by the surviving spouse of the spouse's first annuity payment, the corpus portion of each annuity payment, as determined under paragraph (c)(4) of this section, must, within 60 days of receipt, be transferred to a QDOT. In addition, all annuity payments received during the calendar year must be reported on Form 706–QDT no later than April 15th of the year following the year in which the annuity payments are received, except that in the year of the surviving spouse's death, the Form 706–QDT must be filed no later than the date the estate tax return is filed (or if no return is filed, no later than 9 months from the date of the surviving spouse's death). See § 20.2056A–11 for extensions of time for filing Form 706–QDT.

(ii) *Agreement.* In order for a nonassignable annuity or other payment described in this paragraph (c) to qualify under paragraph (c)(3) of this section, the executor of the decedent's estate must file with the estate tax return the following Agreement To Roll Over Annuity Payments, which must be

signed by the surviving spouse of the decedent (or by the legal representative of the surviving spouse if the surviving spouse is legally incompetent to sign the agreement):

I [*name*] hereby agree that within 60 days of receipt of each annuity payment paid under the [*name of plan or arrangement*], I will transfer an amount equal to _____ percent (the corpus portion determined under § 20.2056A–4(c)(4) of the Estate Tax Regulations) of each annuity payment to [*identify the QDOT*]. Further, I will report all annuity payments received during the calendar year under the [*name of plan or arrangement*] on Form 706–QDT including a schedule of transfers to the [identify the QDOT]. I also agree that Form 706–QDT is to be filed no later than April 15th of the year following the year in which any annuity payments are received except that: in the case of annuity payments received in the year of my spouse's death, Form 706–QDT shall not be due prior to the due date, including extensions, for filing my spouse's estate tax return, or, if no return is filed, no later than 9 months from the date of my spouse's death (except if I am granted an extension of time to file Form 706–QDT under the provisions of § 20.2056A–11); and in the year of my death, the Form 706–QDT must be filed no later than the date my estate tax return is filed (or if no return is filed, no later than 9 months from the date of my death), and except if I am granted an extension of time to file Form 706–QDT under the provisions of § 20.2056A–11. I further agree that if I fail to timely transfer any required amount with respect to any annuity payment, or fail to timely file Form 706–QDT reporting the transfers for any year, I may become immediately liable to pay the amount of the tax determined by application of section 2056A(b)(1) on the entire remaining present value of the annuity, calculated as of the beginning of the year in which the payment was received with respect to which I failed to make the timely transfer or timely file a return. However, I may make an application for relief under § 301.9100–1 of the Procedure and Administration Regulations, from the consequences of failing to timely file Form 706–QDT or failing to timely transfer the corpus portion of any annuity payment to the QDOT. [The following sentence is applicable only in cases where the plan or arrangement is established and administered by a person or an entity that is located outside of the United States.] I agree, at the request of the District Director [or the Assistant Commissioner (International) in the case of a surviving spouse of a nonresident noncitizen decedent or a surviving spouse of a United States citizen who died domiciled outside the United States] to enter into a security agreement to secure my undertakings under this agreement.

(d) *Examples.* The provisions of this section are illustrated by the following examples. In each of the following examples the decedent, *D*, a citizen of the United States, died after August 22, 1995, and *D*'s surviving spouse, *S*, is not a United States citizen at the time of *D*'s death.

Example 1. Transfer and assignment of probate and nonprobate property to QDOT. (i) *S* is the beneficiary of the following probate and nonprobate assets included in *D*'s gross estate:

Pecuniary bequest under will	$400,000
Proceeds of life insurance	200,000
D's interest in property owned jointly with *S* includible in the gross estate under § 2040(a)	300,000
Devise of real property under will	100,000
Total	$1,000,000

(ii) Before the estate tax return for *D*'s estate is filed and before the date that the QDOT election must be made, *S* creates a QDOT pursuant to which all income is payable to *S* for life and the remainder is distributable to *S*'s children. *S* retains a power of appointment over the disposition of the remainder to ensure that *S* does not make an immediate gift of the remainder of the trust. Also, before the estate tax return is filed and before the date that the QDOT election must be made, *S* transfers the life insurance proceeds and the specifically devised real property to the QDOT. *S* decides not to transfer the property that had been jointly owned to the QDOT. Because S has not received distribution of the pecuniary bequest before *D*'s estate tax return is filed and before the date that the QDOT election must be made, *S* irrevocably assigns the interest in the pecuniary bequest to the QDOT. Assume that the pecuniary bequest is in fact transferred by *S* to the QDOT before the estate administration is concluded. *D*'s executor makes a QDOT election on the estate tax return for the $700,000 in property that *S* has transferred and assigned to the QDOT. A marital deduction of $700,000 is allowed to *D*'s estate assuming the estate tax return is filed and the QDOT election is made within the time limitation prescribed in § 20.2056A–3(a). No marital deduction is allowed for the $300,000 interest in jointly-owned property not transferred to the QDOT.

Example 2. Formula assignment. Under the terms of *D*'s will, the entire probate estate passes outright to *S*. Prior to the date *D*'s estate tax return is filed and before the date that the QDOT election must be made, *S* establishes a QDOT and *S* executes an irrevocable assignment in which *S* assigns to the QDOT, ''that portion of the gross estate necessary to reduce the estate tax to zero, taking into account all available credits and deductions.'' The assignment meets the requirements of paragraph (b) of this section, assuming that the QDOT is funded by the time that administration of *D*'s estate is completed.

Example 3. Jointly owned property. At the time of *D*'s death, *D* and *S* hold real property as joint tenants with right of survivorship. In accordance with section 2056(d)(1)(B), section 2040(a), and § 20.2056A–8(a), 60 percent of the value of the property is included in *D*'s gross estate. *S* establishes a QDOT and, prior to the date the estate tax return is filed and before the date that the QDOT election must be made, *S* transfers a 60 percent interest in the real property to the QDOT. The transfer satisfies the requirements of paragraph (b) of this section.

Example 4. Computation of corpus portion of annuity payment. (i) At the time of *D*'s death, *D* is a participant in an employees' pension plan described in section 401(a). On *D*'s death, *D*'s spouse *S*, a resident of the United States, becomes entitled to receive a survivor's annuity of $72,000 per year, payable monthly, for life. At the time of *D*'s death, *S* is age 60. Assume that under section 7520, the appropriate discount rate to be used for valuing annuities in the case of this decedent is 9 percent. The annuity factor at 9 percent for a person age 60 is 8.3031. The adjustment factor at 9 percent for monthly payments is 1.0406. Accordingly, the right to receive $72,000 a year on a monthly basis is equal to the right to receive $74,923 ($72,000 × 1.0406) on an annual basis.

(ii) The corpus portion of each annuity payment received by *S* is determined as follows. The first step is to determine the annuity factor for the number of years that would be required to exhaust a hypothetical fund that has a present value and a payout corresponding to *S*'s interest in the payments under the plan, determined as follows:

(A) Present value of *S*'s annuity: $74,923 x 8.3031 = $622,093

(B) Annuity Factor for Expected Annuity Term: $622,093/$74,923 = 8.3031

(iii) The second step is to determine the number of years that would be required for *S*'s annuity to exhaust a hypothetical fund of $622,093. The term certain annuity factor of 8.3031 falls between the annuity factors for 15 and 16 years in a 9 percent term certain annuity table (Column 1 of Table B, Publication 1457 *Alpha Volume* which may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402). Accordingly, the expected annuity term is 16 years.

(iv) The third step is to determine the corpus amount by dividing the expected term of 16 years into the present value of the hypothetical fund as follows:

Corpus amount of annual payment: $622,093/16 = $38,881

(v) In the fourth step, the corpus portion of each annuity payment is determined by dividing the corpus amount of each annual payment by the annual annuity payment as follows:

Corpus portion of each annuity payment: $38,881/$74,923 = .52

(vi) Accordingly, 52 percent of each payment to *S* is deemed to be a distribution of corpus. A marital deduction is allowed for $622,093, the present value of the annuity as of *D*'s date of death, if either: *S* agrees to roll over the corpus portion of each payment to a QDOT and the executor files the Information Statement described in paragraph (c)(5) of this section and the Roll Over Agreement described in paragraph (c)(7) of this section; or *S* agrees to pay the tax due on the corpus portion of each payment and the executor files the Information Statement described in paragraph (c)(5) of this section and the Payment Agreement described in paragraph (c)(6) of this section.

Example 5. Transfer to QDOT subject to gift tax. D's will bequeaths $700,000 outright to *S*. The bequest qualifies for a marital deduction under section 2056(a) except that it does not pass in a QDOT. *S* creates an irrevocable trust that meets the requirements for a QDOT and transfers the $700,000 to the QDOT. The QDOT instrument provides that *S* is entitled to all the income from the QDOT payable at least annually and that, upon the death of *S*, the property remaining in the QDOT is to be distributed to the grandchildren of *D* and *S* in equal shares. The trust instrument contains all other provisions required to qualify as a QDOT. On *D*'s estate tax return, *D*'s executor makes a QDOT election under section 2056A(a)(3). Solely for purposes of the marital deduction, the property is deemed to pass from *D* to the QDOT. *D*'s estate is entitled to a marital deduction for the $700,000 value of the property passing from *D* to *S*. *S*'s transfer of property to the QDOT is treated as a gift of the remainder interest for gift tax purposes because *S*'s transfer creates a vested remainder interest in the grandchildren of *D* and *S*. Accordingly, as of the date that *S* transfers the property to the QDOT, a gift tax is imposed on the present value of the remainder interest. See § 25.2702–1(c)(8) of this chapter exempting *S*'s transfer from the special valuation rules contained in section 2702. At *S*'s death, *S* is treated as the transferor of the property into the trust for estate tax and generation-skipping transfer tax purposes. See, e.g., sections 2036 and 2652(a)(1). The trust is not eligible for a reverse QTIP election by *D*'s estate under section 2652(a)(3) because a QTIP election cannot be made for the QDOT. This is so because the marital deduction is allowed under section 2056(a) for the outright bequest to the spouse and the spouse is then separately treated as the transferor of the property to the QDOT.

§ 20.2056A–5 Imposition of section 2056A estate tax.

(a) *In general.* An estate tax is imposed under section 2056A(b)(1) on the occurrence of a taxable event, as defined in section 2056A(b)(9). The tax is generally equal to the amount of estate tax that would have been imposed if the amount involved in the taxable event had been included in the decedent's taxable estate and had not been deductible under section 2056. See section 2056A(b)(3) and paragraph (c) of this section for certain exceptions from taxable events.

(b) *Amounts subject to tax*—(1) *Distribution of principal during the spouse's lifetime.* If a taxable event occurs during the noncitizen surviving spouse's lifetime, the amount on which the section 2056A estate tax is imposed is the amount of money and the fair market value of the property that is the subject of the distribution (including property distributed from the trust pursuant to the exercise of a power of appointment), including any amount withheld from the distribution by the U.S. Trustee to pay the tax. If, however, the tax is not withheld by the U.S. Trustee but is paid by the U.S. Trustee out of other assets of the QDOT, an amount equal to the tax so paid is treated as an additional distribution to the spouse in the year that the tax is paid.

(2) *Death of surviving spouse.* If a taxable event occurs as a result of the death of the surviving spouse, the amount subject to tax is the fair market value of the trust assets on the date of the spouse's death (or alternate valuation date if applicable). See also section 2032A. Any corpus portion amounts, within the meaning of § 20.2056A–4(c)(4)(i), remaining in a QDOT upon the surviving spouse's death, are subject to tax under section 2056A(b)(1)(B), as well as any residual payments resulting from a nonassignable plan or arrangement that, upon the surviving spouse's death, are payable to the spouse's estate or to successor beneficiaries.

(3) *Trust ceases to qualify as QDOT.* If a taxable event occurs as a result of the trust ceasing to qualify as a QDOT (for example, the trust ceases to have at least one U.S. Trustee), the amount subject to tax is the fair market value of the trust assets on the date of disqualification.

(c) *Distributions and dispositions not subject to tax*—(1) *Distributions of principal on account of hardship.* Section 2056A(b)(3)(B) provides an exemption from the section 2056A estate tax for distributions to the surviving spouse on account of hardship. A distribution of principal is treated as made on account of hardship if the distribution is made to the spouse from the QDOT in response to an immediate and substantial financial need relating to the spouse's health, maintenance, education, or support, or the health, maintenance, education, or support of any person that the surviving spouse is legally obligated to support. A distribution is not treated as made on account of hardship if the amount distributed may be obtained from other sources that are reasonably available to the surviving spouse; e.g., the sale by the surviving spouse of personally owned, publicly traded stock or the cashing in of a certificate of deposit owned by the surviving spouse. Assets such as closely held business interests, real estate and tangible personalty are not considered sources that are reasonably available to the surviving spouse. Although a hardship distribution of principal is exempt from the section 2056A estate tax, it must be reported on Form 706–QDT even if it is the only distribution that occurred during the filing period. See § 20.2056A–11 regarding filing requirements for Form 706–QDT.

(2) *Distributions of income to the surviving spouse.* Section 2056A(b)(3)(A) provides an exemption from the section 2056A estate tax for distributions of income to the surviving spouse. In general, for purposes of section 2056A(b)(3)(A), the term *income* has the same meaning as is provided in section 643(b), except that income does not include capital gains. In addition, income does not include any other item that would be allocated to corpus under applicable local law governing the administration of trusts irrespective of any specific trust provision to the contrary. In cases where there is no specific statutory or case law regarding the allocation of such items under the law governing the administration of the QDOT, the allocation under this paragraph (c)(2) will be governed by general principles of law (including but not limited to any uniform state acts, such as the Uniform Principal and Income Act, or any Restatements of applicable law). Further, except as provided in this paragraph (c)(2) or in administrative guidance published by the Internal Revenue Service, income does not include items constituting income in respect of a decedent (IRD) under section 691. However, in cases where a QDOT is designated by the decedent as a beneficiary of a pension or profit sharing plan described in section 401(a) or an individual retirement account or annuity described in section 408, the proceeds of which are payable to the QDOT in the form of an annuity, any payments received by the QDOT may be allocated between income and corpus using the method prescribed under § 20.2056A–4(c) for determining the corpus and income portion of an annuity payment.

(3) *Certain miscellaneous distributions and dispositions.* Certain miscellaneous distributions and dispositions of trust assets are exempt from the section 2056A estate tax, including but not limited to the following—

(i) Payments for ordinary and necessary expenses of the QDOT (including bond premiums and letter of credit fees);

(ii) Payments to applicable governmental authorities for income tax or any other applicable tax imposed on the QDOT (other than a payment of the section 2056A estate tax due on the occurrence of a taxable event as described in paragraph (b) of this section);

(iii) Dispositions of trust assets by the trustees (such as sales, exchanges, or pledging as collateral) for full and adequate consideration in money or money's worth; and

(iv) Pursuant to section 2056A(b)(15), amounts paid from the QDOT to reimburse the surviving spouse for any tax imposed on the spouse under Subtitle A of the Internal Revenue Code on any item of income of the QDOT to which the surviving spouse is not entitled under the terms of the trust. Such distributions include (but are not limited to) amounts paid from the QDOT to reimburse the spouse for income taxes paid by the spouse (either by actual payment or through withholding) with respect to amounts received from a nonassignable annuity or other arrangement that are transferred by the spouse to a QDOT pursuant to § 20.2056A– 4(c)(3); and income taxes paid by the spouse (either by actual payment or through withholding) with respect to amounts received in a lump sum distribution from a qualified plan if the lump sum distribution is assigned by the surviving spouse to a QDOT. For purposes of this paragraph (c)(3)(iv), the amount of attributable tax eligible for reimbursement is the difference between the actual income tax liability of the spouse and the spouse's income tax liability determined as if the item had not been included in the spouse's gross income in the applicable taxable year.

§ 20.2056A–6 Amount of tax.

(a) *Definition of tax.* Section 2056A(b)(2) provides for the computation of the section 2056A estate tax. For purposes of sections 2056A(b)(2)(A) (i) and (ii), in determining the tax that would have been imposed under section 2001 on the estate of the first decedent, the rates in effect on the date of the first decedent's death are used. For this purpose, the provisions of section 2001(c)(2) (pertaining to phaseout of graduated rates and unified credit) apply. In addition, for purposes of sections 2056A(b)(2)(A) (i) and (ii), *the tax which would have been imposed by section 2001 on the estate of the decedent* means the net tax determined under section 2001 or 2101, as the case may be, after allowance of any allowable credits, including the unified credit allowable under section 2010, the credit for state death taxes under section 2011, the credit for tax on prior transfers under section 2013, and the credit for foreign death taxes under section 2014. See paragraph (b)(4) of this section regarding the application of the credits under sections 2011 and 2014. In the case of a decedent nonresident not a citizen of the United States, the applicable credits are determined under section 2102. The estate tax (net of any applicable credits) imposed under section 2056A(b)(1) constitutes an estate tax for purposes of section 691(c)(2)(A).

(b) *Benefits allowed in determining amount of section 2056A estate tax*—(1) *General rule.* Section 2056A(b)(10) provides for the allowance of certain benefits in computing the section 2056A estate tax. Except as provided in this section, the rules of each of the credit, deduction and deferral provisions, as provided in the Internal Revenue Code must be complied with.

(2) *Treatment as resident.* For purposes of section 2056A(b)(10)(A), a noncitizen spouse is treated as a resident of the United States for purposes of determining whether the QDOT property is includible in the spouse's gross estate under chapter 11 of the Internal Revenue Code, and for purposes of determining whether any of the credits, deductions or deferral provisions are allowable with respect to the QDOT property to the estate of the spouse.

(3) *Special rule in the case of trusts described in section 2056(b)(8).* In the case of a QDOT in which the spouse's interest qualifies for a marital deduction under section 2056(b)(8), the provisions of section 2056A(b)(10)(A) apply in determining the allowance of a charitable deduction in computing the section 2056A estate tax, notwithstanding that the QDOT is not includible in the spouse's gross estate.

(4) *Credit for state and foreign death taxes.* If the assets of the QDOT are included in the surviving spouse's gross estate for federal estate tax purposes, or would have been so includible if the spouse had been a United States resident, and state or foreign death taxes are paid by the spouse's estate with respect to the QDOT, the taxes paid by the spouse's estate with respect to the QDOT are creditable, to the extent allowable under section 2011 or 2014, as applicable, in computing the section 2056A estate tax. In addition, state or foreign death taxes previously paid by the decedent/transferor's estate are also creditable in computing the section 2056A estate tax to the extent allowable under sections 2011 and 2014. Specifically, the tax that would have been imposed on the decedent's estate if the taxable estate had been increased by the value of the QDOT assets on the spouse's death plus the amount involved in prior taxable events (section 2056A(b)(2)(A)(i)), is determined after allowance of a credit equal to the lesser of the state or foreign death tax previously paid by the decedent's estate, or the amount prescribed under section 2011(b) or 2014(b) computed based on a taxable estate increased by such amounts. Similarly, the tax that would have been imposed on the decedent's estate if the taxable estate had been increased only by the amount involved in prior taxable events (section 2056A(b)(2)(A)(ii)) is determined after allowance of a credit equal to the lesser of the state or foreign death tax previously paid by the decedent's estate, or the amount prescribed under section 2011(b) or 2014(b) computed based on a taxable estate increased by the amount involved in such prior taxable events. See paragraph (d), *Example 2*, of this section.

(5) *Alternate valuation and special use valuation*—(i) *In general.* In order to claim the benefits of alternate valuation under section 2032, or special use valuation under section 2032A, for purposes of computing the section 2056A estate tax, an election must be made on the Form 706–QDT that is filed with respect to the balance remaining in the QDOT upon the death of the surviving spouse. In addition, the separate requirements for making the section 2032 and/or section 2032A elections under those sections and the regulations thereunder must be complied with except that, for this purpose, the surviving spouse is treated as a resident of the United States regardless of the surviving spouse's actual residency status. Solely for purposes of this paragraph (b)(5), the citizenship of the first decedent is immaterial.

(ii) *Alternate valuation.* For purposes of the alternate valuation election under section 2032, the election may not be made unless the election decreases both the value of the property remaining in the QDOT upon the death of the surviving spouse and the net amount of section 2056A estate tax due. Once made, the election is irrevocable.

(iii) *Special use valuation.* For purposes of section 2032A, the Designated Filer (in the case of multiple QDOTs) or the U.S. Trustee may elect to value certain farm and closely held business real property at its farm or business use value, rather than its fair market value, if all of the requirements under section 2032A and the applicable regulations are met, except that, for this purpose, the surviving spouse is treated as a resident of the United States regardless of the spouse's actual residency status. The total value of property valued under section 2032A in the QDOT cannot be decreased from fair market value by more than $750,000.

(c) *Miscellaneous rules.* See sections 2056A(b)(2)(B)(i) and 2056A(b)(2)(C) for special rules regarding the appropriate rate of tax. See section 2056A(b)(2)(B)(ii) for provisions regarding a credit or refund with respect to the section 2056A estate tax.

(d) *Examples.* The rules of this section are illustrated by the following examples.

Example 1. (i) *D*, a United States citizen, dies in 1995 a resident of State X, with a gross estate of $1,200,000. Under *D*'s will, a pecuniary bequest of $700,000 passes to a QDOT for the benefit of *D*'s spouse S, who is a resident but not a citizen of the United States. *D*'s estate tax is computed as follows:

Gross estate	$1,200,000	
Marital Deduction	(700,000)	
Taxable Estate	$500,000	
Gross Tax		$155,800
Less: Unified Credit		(155,800)
Net Tax		0

(ii) *S* dies in 1997 at which time *S* is still a resident of the United States and the value of the assets of the QDOT is $700,000. Assuming there were no taxable events during *S*'s lifetime with respect to the QDOT, the estate tax imposed under section 2056A(b)(1)(B) is $235,000, computed as follows:

D's actual taxable estate	$500,000	
QDOT property	700,000	
Total	$1,200,000	
Gross Tax		$427,800
Less: Unified Credit		(192,800)
Net Tax		§ 235,000
Less: Tax that would have been imposed on *D*'s actual taxable estate of $500,000		0
Section 2056A Estate Tax		$235,000

Example 2. (i) The facts are the same as in *Example 1*, except that *D*'s gross estate was $2,000,000 and *D*'s estate paid $70,000 in state death taxes to State X. *D*'s estate tax is computed as follows:

Gross Estate	$2,000,000		
Marital Deduction	(700,000)		
Taxable Estate	$1,300,000		
Gross Tax			$469,800
Less: Unified Credit		192,800	
State Death Tax Credit Limitation (lesser of $51,600 or $70,000 tax paid)		51,600	(244,400)
Estate Tax			$225,400

(ii) *S* dies in 1997 at which time *S* is still a resident of the United States and the value of the assets of the QDOT is $800,000. *S*'s estate pays $40,000 in State X death taxes with respect to the inclusion of the QDOT in *S*'s gross estate for state death tax purposes. Assuming there were no taxable events during *S*'s lifetime with respect to the QDOT, the estate tax imposed under section 2056A(b)(1)(B) is $304,800 computed as follows:

D's Actual Taxable Estate	$1,300,000	
QDOT Property	800,000	
Total	$2,100,000	
Gross Tax		$829,800
Less: Unified Credit		(192,800)
Pre-2011 section 2056A estate tax		$637,000
(A) State Death Tax Credit Computation:		
(1) State death tax paid by *S*'s estate with respect to the QDOT [$40,000] plus state death tax previously paid by *D*'s estate [$70,000] = $110,000.		
(2) Credit limit under section 2011(b) (based on *D*'s adjusted taxable estate of $2,040,000 under sections 2056A(b)(2)(A) and 2011(b)) = $106,800.		

(B) State death tax credit allowable against section 2056A estate tax (lesser of paragraph (ii)(A)(1) or (2) of this Example 2	.....	(106,800)
Net Tax	.....	$530,200
Less: Tax that would have been imposed on *D*'s taxable estate of $1,300,000	.....	225,400
Section 2056A Estate Tax	.....	$304,800

§ 20.2056A–7 Allowance of prior transfer credit under section 2013.

(a) *Property subject to QDOT election.* Section 2056(d)(3) provides special rules for computing the section 2013 credit allowed with respect to property subject to a QDOT election. In computing the credit under section 2013, the amount of the credit is determined under section 2013 and the regulations thereunder, except that—

(1) The first limitation as described in section 2013(b) and § 20.2013–2 is the amount of the estate tax imposed under section 2056A(b)(1)(A), with respect to distributions during the spouse's life, and under section 2056A(b)(1)(B), with respect to the value of the QDOT assets on the spouse's death;

(2) In computing the second limitation as described in section 2013(c) and § 20.2013–3, the value of the property transferred to the decedent (as defined in section 2013(d) and § 20.2013–4) is deemed to be the value of the QDOT assets on the date of death of the surviving spouse. The value as so determined is not reduced by the section 2056A estate tax imposed at the time of the spouse's death; and

(3) The amount of the credit is determined without regard to the percentage limitations contained in section 2013(a).

(b) *Property not subject to QDOT election.* If property includible in a decedent's gross estate passes to a noncitizen surviving spouse (the transferee) and no deduction is allowed to the decedent's estate for that interest in property under section 2056(a) solely because the requirements of section 2056(d)(2) are not satisfied, and the transferee spouse dies with an estate that is subject to tax under section 2001 or 2101, as the case may be, any credit for tax on prior transfers allowable to the estate of the transferee spouse under section 2013 with respect to such interest in property is determined in accordance with the rules of section 2013 and the regulations thereunder, except that the amount of the credit is determined without regard to the percentage limitations contained in section 2013(a).

(c) *Example.* The application of this section may be illustrated by the following example:

Example. The facts are the same as in § 20.2056A–6, *Example 2*(ii). *D*, a United States citizen, dies in 1994, a resident of State X, with a gross estate of $2,000,000. Under *D*'s will, a pecuniary bequest of $700,000 passes to a QDOT for the benefit of *D*'s spouse *S*, who is a resident but not a citizen of the United States. *S* dies in 1997 at which time *S* is still a resident of the United States and the value of the assets of the QDOT is $800,000. There were no taxable events during *S*'s lifetime. An estate tax of $304,800 is imposed under section 2056A(b)(1)(B). *S*'s taxable estate, including the value of the QDOT ($800,000), is $1,500,000.

(i) Under paragraph (a)(1) of this section, the first limitation for purposes of section 2013(b) is $304,800, the amount of the section 2056A estate tax.

(ii) Under paragraph (a)(2) of this section, the second limitation for purposes of section 2013(c) is computed as follows:

(A) *S*'s net estate tax payable under § 20.2013–3(a)(1), as modified under paragraph (a)(2) of this section, is computed as follows:

Taxable estate ..	.....	$1,500,000
Gross estate tax	.....	555,800
Less: Unified credit	$192,800	.....
Credit for state death taxes	64,400	257,200
Pre-2013 net estate tax payable	.....	$298,600

(B) *S*'s net estate tax payable under § 20.2013–3(a)(2), as modified under paragraph (a)(2) of this section, is computed as follows:

Taxable estate ..	.....	$700,000
Gross estate tax	.....	229,800
Less: Unified credit	$192,800	.....
Credit for state death taxes	18,000	210,800
Net tax payable	.....	$19,000
(C) *Second Limitation:* Paragraph (ii)(A) of this *Example*	$298,600	.....
Less: Paragraph (ii)(B) of this *Example*	19,000	
		$279,600

(iii) Credit for tax on prior transfers = $279,600 (lesser of paragraphs (i) or (ii) of this *Example.*

§ 20.2056A–8 Special rules for joint property.

(a) *Inclusion in gross estate*—(1) *General rule.* If property is held by the decedent and the surviving spouse of the decedent as joint tenants with right of survivorship, or as tenants by the entirety, and the surviving spouse is not a United States citizen (or treated as a United States citizen) at the time of the decedent's death, the property is subject to inclusion in the decedent's gross estate in accordance with the rules of section 2040(a) (general rule for includibility of joint interests), and section 2040(b) (special rule for includibility of certain joint interests of husbands and wives) does not apply. Accordingly, the rules contained in section 2040(a) and § 20.2040–1 govern the extent to which such joint interests are includible in the gross estate of a decedent who was a citizen or resident of the United States. Under § 20.2040–1(a)(2), the entire value of jointly held property is included in the decedent's gross estate unless the executor submits facts sufficient to show that property was not entirely acquired with consideration furnished by the decedent, or was acquired by the decedent and the other joint owner by gift, bequest, devise or inheritance. If the decedent is a nonresident not a citizen of the United States, the rules of this paragraph (a)(1) apply pursuant to sections 2103, 2031, 2040(a), and 2056(d)(1)(B).

(2) *Consideration furnished by surviving spouse.* For purposes of applying section 2040(a), in determining the amount of consideration furnished by the surviving spouse, any consideration furnished by the decedent with respect to the property before July 14, 1988, is treated as consideration furnished by the surviving spouse to the

extent that the consideration was treated as a gift to the spouse under section 2511, or to the extent that the decedent elected to treat the transfer as a gift to the spouse under section 2515 (to the extent applicable). For purposes of determining whether the consideration was a gift by the decedent under section 2511, it is presumed that the decedent was a citizen of the United States at the time the consideration was so furnished to the spouse. The special rule of this paragraph (a)(2) is applicable only if the donor spouse predeceases the donee spouse and not if the donee spouse predeceases the donor spouse. In cases where the donee spouse predeceases the donor spouse, any portion of the consideration treated as a gift to the donee spouse/decedent on the creation of the tenancy (or subsequently thereafter), regardless of the date the tenancy was created, is not treated as consideration furnished by the donee spouse/decedent for purposes of section 2040(a).

(3) *Amount allowed to be transferred to QDOT.* If, as a result of the application of the rules described above, only a portion of the value of a jointly-held property interest is includible in a decedent's gross estate, only that portion that is so includible may be transferred to a QDOT under section 2056(d)(2). See § 20.2056A–4(b)(1) and (d), *Example 3.*

(b) *Surviving spouse becomes citizen.* Paragraph (a) of this section does not apply if the surviving spouse meets the requirements of section 2056(d)(4). For the definition of resident in applying section 2056(d)(4), see § 20.0–1(b).

(c) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. In 1987, *D,* a United States citizen, purchases real property and takes title in the names of *D* and *S, D*'s spouse (a noncitizen, but a United States resident), as joint tenants with right of survivorship. In accordance with § 25.2511–1(h)(5) of this chapter, one-half of the value of the property is a gift to *S*. *D* dies in 1995. Because *S* is not a United States citizen, the provisions of section 2040(a) are determinative of the extent to which the real property is includible in *D*'s gross estate. Because the joint tenancy was established before July 14, 1988, and under the applicable provisions of the Internal Revenue Code and regulations the transfer was treated as a gift of one-half of the property, one-half of the value of the property is deemed attributable to consideration furnished by *S* for purposes of section 2040(a). Accordingly, only one-half of the value of the property is includible in *D*'s gross estate under section 2040(a).

Example 2. The facts are the same as in *Example 1,* except that *S* dies in 1995 survived by *D* who is not a citizen of the United States. For purposes of applying section 2040(a), *D*'s gift to *S* on the creation of the tenancy is not treated as consideration furnished by *S* toward the acquisition of the property. Accordingly, since *S* made no other contributions with respect to the property, no portion of the property is includible in *S*'s gross estate.

Example 3. The facts are the same as in *Example 1,* except that *D* and *S* purchase real property in 1990 making the down payment with funds from a joint bank account. All subsequent mortgage payments and improvements are paid from the joint bank account. The only funds deposited in the joint bank account are the earnings of *D* and *S*. It is established that *D* earned approximately 60% of the funds and *S* earned approximately 40% of the funds. *D* dies in 1995. The establishment of *S*'s contribution to the joint bank account is sufficient to show that *S* contributed 40% of the consideration for the property. Thus, under paragraph § 20.2040–1(a)(2), 60% of the value of the property is includible in *D*'s gross estate.

§ 20.2056A–9 Designated Filer.

Section 2056A(b)(2)(C) provides special rules where more than one QDOT is established with respect to a decedent. The designation of a person responsible for filing a return under section 2056A(b)(2)(C)(i) (the Designated Filer) must be made on the decedent's federal estate tax return, or on the first Form 706–QDT that is due and is filed by its prescribed date, including extensions. The Designated Filer must be a U.S. Trustee. If the U.S. Trustee is an individual, that individual must have a tax home (as defined in section 911(d)(3)) in the United States. At least sixty days before the due date for filing the tax returns for all of the QDOTs, the U.S. Trustee(s) of each of the QDOTs must provide to the Designated Filer all of the necessary information relating to distributions from their respective QDOTs. The section 2056A estate tax due from each QDOT is allocated on a pro rata basis (based on the ratio of the amount of each respective distribution constituting a taxable event to the amount of all such distributions), unless a different allocation is required under the terms of the governing instrument or under local law. Unless the decedent has provided for a successor Designated Filer, if the Designated Filer ceases to qualify as a U.S. Trustee, or otherwise becomes unable to serve as the Designated Filer, the remaining trustees of each QDOT must select a qualifying successor Designated Filer (who is also a U.S. Trustee) prior to the due date for the filing of Form 706–QDT (including extensions). The selection is to be indicated on the Form 706–QDT. Failure to select a successor Designated Filer will result in the application of section 2056A(b)(2)(C).

§ 20.2056A–10 Surviving spouse becomes citizen after QDOT established.

(a) *Section 2056A estate tax no longer imposed under certain circumstances.* Section 2056A(b)(12) provides that a QDOT is no longer subject to the imposition of the section 2056A estate tax if the surviving spouse becomes a citizen of the United States and the following conditions are satisfied—

(1) The spouse either was a United States resident (for the definition of resident for this purpose, see § 20.2056A–1(b)) at all times after the death of the decedent and before becoming a United States citizen, or no taxable distributions are made from the QDOT before the spouse becomes a United States citizen (regardless of the residency status of the spouse); and

(2) The U.S. Trustee(s) of the QDOT notifies the Internal Revenue Service and certifies in writing that the surviving spouse has become a United States citizen. Notice is to be made by filing a final Form 706–QDT on or before April 15th of the calendar year following the year in which the surviving spouse becomes a United States citizen, unless an extension of time for filing is granted under section 6081.

(b) *Special election by spouse.* If the surviving spouse becomes a United States citizen and the spouse is not a United States resident at all times after the death of the decedent and before becoming a United States citizen, and a tax was previously imposed under section 2056A(b)(1)(A) with respect to any distribution from the QDOT before the surviving spouse becomes a United States citizen, the estate tax imposed under section 2056A(b)(1) does not apply to distributions after the spouse becomes a citizen if—

(1) The spouse elects to treat any taxable distribution from the QDOT prior to the spouse's election as a taxable gift made by the spouse for purposes of section 2001(b)(1)(B) (referring to adjusted taxable gifts), and for purposes of determining the amount of the tax imposed by section 2501 on actual taxable gifts made by the spouse during the year in which the spouse becomes a citizen or in any subsequent year;

(2) The spouse elects to treat any previous reduction in the section 2056A estate tax by reason of the decedent's unified credit (under either section 2010 or section 2102(c)) as a reduction in the spouse's unified credit under section 2505 for purposes of determining the amount of the credit allowable with

respect to taxable gifts made by the surviving spouse during the taxable year in which the spouse becomes a citizen, or in any subsequent year; and

(3) The elections referred to in this paragraph (b) are made by timely filing a Form 706–QDT on or before April 15th of the year following the year in which the surviving spouse becomes a citizen (unless an extension of time for filing is granted under section 6081) and attaching notification of the election to the return.

§ 20.2056A–11 Filing requirements and payment of the section 2056A estate tax.

(a) *Distributions during surviving spouse's life.* Section 2056A(b)(5)(A) provides the due date for payment of the section 2056A estate tax imposed on distributions during the spouse's lifetime. An extension of not more than 6 months may be obtained for the filing of Form 706–QDT under section 6081(a) if the conditions specified therein are satisfied. See also § 20.2056A- 5(c)(1) regarding the requirements for filing a Form 706–QDT in the case of a distribution to the surviving spouse on account of hardship, and § 20.2056A–2T(d)(3) regarding the requirements for filing Form 706–QDT in the case of the required annual statement.

(b) *Tax at death of surviving spouse.* Section 2056A(b)(5)(B) provides the due date for payment of the section 2056A estate tax imposed on the death of the spouse under section 2056A(b)(1)(B). An extension of not more than 6 months may be obtained for the filing of the Form 706–QDT under section 6081(a), if the conditions specified therein are satisfied. The obtaining of an extension of time to file under section 6081(a) does not extend the time to pay the section 2056A estate tax as prescribed under section 2056A(b)(5)(B).

(c) *Extension of time for paying section 2056A estate tax—(1) Extension of time for paying tax under section 6161(a)(2).* Pursuant to sections 2056A(b)(10)(C) and 6161(a)(2), upon a showing of reasonable cause, an extension of time for a reasonable period beyond the due date may be granted to pay any part of the estate tax that is imposed upon the surviving spouse's death under section 2056A(b)(1)(B) and shown on the final Form 706–QDT, or any part of any installments of such tax payable under section 6166 (including any part of a deficiency prorated to any installment under such section). The extension may not exceed 10 years from the date prescribed for payment of the tax (or in the case of an installment or part of a deficiency prorated to an installment, if later, not beyond the date that is 12 months after the due date for the last installment). Such extension may be granted by the district director or the director of the service center where the Form 706–QDT is filed.

(2) *Extension of time for paying tax under section 6161(a)(1).* An extension of time beyond the due date to pay any part of the estate tax imposed on lifetime distributions under section 2056A(b)(1)(A), or imposed at the death of the surviving spouse under section 2056A(b)(1)(B), may be granted for a reasonable period of time, not to exceed 6 months (12 months in the case of the estate tax imposed under section 2056A(b)(1)(B) at the surviving spouse's death), by the district director or the director of the service center where the Form 706–QDT is filed.

(d) *Liability for tax.* Under section 2056A(b)(6), each trustee (and not solely the U.S. Trustee(s)) of a QDOT is personally liable for the amount of the estate tax imposed in the case of any taxable event under section 2056A(b)(1). In the case of multiple QDOTs with respect to the same decedent, each trustee of a QDOT is personally liable for the amount of the section 2056A estate tax imposed on any taxable event with respect to that trustee's QDOT, but is not personally liable for tax imposed with respect to taxable events involving QDOTs of which that person is not a trustee. However, the assets of any QDOT are subject to collection by the Internal Revenue Service for any tax resulting from a taxable event with respect to any other QDOT established with respect to the same decedent. The trustee may also be personally liable as a withholding agent under section 1461 or other applicable provisions of the Internal Revenue Code.

§ 20.2056A–12 Increased basis for section 2056A estate tax paid with respect to distribution from a QDOT.

Under section 2056A(b)(13), in the case of any distribution from a QDOT on which an estate tax is imposed under section 2056A(b)(1)(A), the distribution is treated as a transfer by gift for purposes of section 1015, and any estate tax paid under section 2056A(b)(1)(A) is treated as a gift tax. See § 1.1015–5(c)(4) and (5) of this chapter for rules for determining the amount by which the basis of the distributed property is increased.

§ 20.2056A–13 Effective date.

The provisions of §§ 20.2056A–1 through 20.2056A–12 are effective with respect to estates of decedents dying after August 22, 1995.

Par. 7. § 20.2101–1 is revised to read as follows:

§ 20.2101–1 Estates of nonresidents not citizens; tax imposed.

(a) *Imposition of tax.* Section 2101 imposes a tax on the transfer of the taxable estate of a nonresident who is not a citizen of the United States at the time of death. In the case of estates of decedents dying after November 10, 1988, the tax is computed at the same rates as the tax that is imposed on the transfer of the taxable estate of a citizen or resident of the United States in accordance with the provisions of sections 2101(b) and (c). For the meaning of the terms *resident, nonresident,* and *United States*, as applied to a decedent for purposes of the estate tax, see § 20.0–1(b)(1) and (2). For the liability of the executor for the payment of the tax, see section 2002. For special rules as to the phaseout of the graduated rates and unified credit, see sections 2001(c)(2) and 2101(b).

(b) *Special rates in the case of certain decedents.* In the case of an estate of a nonresident who was not a citizen of the United States and who died after December 31, 1976, and on or before November 10, 1988, the tax on the nonresident's taxable estate is computed using the formula provided under section 2101(b), except that the rate schedule in paragraph (c) of this section is to be used in lieu of the rate schedule in section 2001(c).

(c) *Rate schedule for decedents dying after December 31, 1976 and on or before November 10, 1988.*

If the amount for which the tentative tax to be computed is:	The tentative tax is:
Not over $100,000	6% of such amount.
Over $100,000 but not over $500,000	$6,000, plus 12% of excess over $100,000.
Over $500,000 but not over $1,000,000	$54,000, plus 18% of excess over $500,000.
Over $1,000,000 but not over $2,000,000	$144,000, plus 24% of excess over $1,000,000.
Over $2,000,000	$384,000, plus 30% of excess over $2,000,000.

Par. 8. Section 20.2102–1 is amended by adding paragraph (c) to read as follows:

§ 20.2102–1 Estates of nonresidents not citizens; credits against tax.

* * * * *

(c) *Unified credit—*

(1) *In general.* Subject to paragraph (c)(2) of this section, in the case of estates of decedents dying after November 10, 1988, a unified credit of $13,000 is allowed against the tax imposed by section 2101 subject to the limitations of section 2102(c).

(2) *When treaty is applicable.* To the extent required under any treaty obligation of the United States, the estate of a nonresident not a citizen of the United States is allowed the unified credit permitted to a United States citizen or resident of $192,800, multiplied by the proportion that the total gross estate of the decedent situated in the United States bears to the decedent's total gross estate wherever situated.

(3) *Certain residents of possessions.* In the case of a decedent who is considered to be a nonresident not a citizen of the United States under section 2209, there is allowed a unified credit equal to the greater of $13,000, or $46,800 multiplied by the proportion that the decedent's gross estate situated in the United States bears to the total gross estate of the decedent wherever situated.

Par. 9. Section 20.2106–1 is amended as follows:

1. Paragraph (a)(3) is revised.

2. The last sentence of paragraph (b) is removed.

3. Paragraph (c) is removed.

The revision reads as follows:

§ 20.2106–1 Estates of nonresidents not citizens; taxable estate; deductions in general.

(a) * * *

(3) Subject to the special rules set forth at § 20.2056A–1(c), the amount which would be deductible with respect to property situated in the United States at the time of the decedent's death under the principles of section 2056. Thus, if the surviving spouse of the decedent is a citizen of the United States at the time of the decedent's death, a marital deduction is allowed with respect to the estate of the decedent if all other applicable requirements of section 2056 are satisfied. If the surviving spouse of the decedent is not a citizen of the United States at the time of the decedent's death, the provisions of section 2056, including specifically the provisions of section 2056(d) and (unless section 2056(d)(4) applies) the provisions of section 2056A (QDOTs) must be satisfied.

* * * * *

§ 20.2106–2 [Amended]

Par. 10. In § 20.2106–2, paragraph (c) is removed and reserved.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31,1954

Par. 11. The authority citation for part 25 is revised to read as follows:

Authority: 26 U.S.C. 7805.

Par. 12. Section 25.2503–2 is amended as follows:

1. The first sentence in paragraph (a) is revised.

2. Paragraph (f) is added.

3. The revision and addition read as follows:

§ 25.2503–2 Exclusion from gifts.

(a) * * * Except as provided in paragraph (f) of this section (involving gifts to a noncitizen spouse), the first $10,000 of gifts made to any one donee during the calendar year 1982 or any calendar year thereafter, except gifts of future interests in property as defined in §§ 25.2503–3 and 25.2503–4, is excluded in determining the total amount of gifts for the calendar year. * * *

* * * * *

(f) *Special rule in the case of gifts made on or after July 14, 1988, to a spouse who is not a United States citizen*—(1) *In general.* Subject to the special rules set forth at § 20.2056A–1(c) of this chapter, in the case of gifts made on or after July 14, 1988, if the donee of the gift is the donor's spouse and the donee spouse is not a citizen of the United States at the time of the gift, the first $100,000 of gifts made during the calendar year to the donee spouse (except gifts of future interests) is excluded in determining the total amount of gifts for the calendar year. The rule of this paragraph (f) applies regardless of whether the donor is a citizen or resident of the United States for purposes of chapter 12 of the Internal Revenue Code.

(2) *Gifts made after June 29, 1989.* In the case of gifts made after June 29, 1989, the $100,000 exclusion provided in paragraph (f)(1) of this section applies only if the gift in excess of the otherwise applicable annual exclusion is in a form that qualifies for the gift tax marital deduction under section 2523(a) but for the provisions of section 2523(i)(1) (disallowing the marital deduction if the donee spouse is not a United States citizen.) See § 25.2523(i)–1(d), *Example 4.*

(3) *Effective date.* This paragraph (f) is effective with respect to gifts made after August 22, 1995.

Par. 13. §§ 25.2523(i)–1, 25.2523(i)–2 and 25.2523(i)–3 are added to read as follows:

§ 25.2523(i)–1 Disallowance of marital deduction when spouse is not a United States citizen.

(a) *In general.* Subject to § 20.2056A–1(c) of this chapter, section 2523(i)(1) disallows the marital deduction if the spouse of the donor is not a citizen of the United States at the time of the gift. If the spouse of the donor is a citizen of the United States at the time of the gift, the gift tax marital deduction under section 2523(a) is allowed regardless of whether the donor is a citizen or resident of the United States at the time of the gift, subject to the otherwise applicable rules of section 2523.

(b) *Exception for certain joint and survivor annuities.* Paragraph (a) does not apply to disallow the marital deduction with respect to any transfer resulting in the acquisition of rights by a noncitizen spouse under a joint and survivor annuity described in section 2523(f)(6).

(c) *Increased annual exclusion*—(1) *In general.* In the case of gifts made from a donor to the donor's spouse for which a marital deduction is not allowable under this section, if the gift otherwise qualifies for the gift tax annual exclusion under section 2503(b), the amount of the annual exclusion under section 2503(b) is $100,000 in lieu of $10,000. However, in the case of gifts made after June 29, 1989, in order for the increased annual exclusion to apply, the gift in excess of the otherwise applicable annual exclusion under section 2503(b) must be in a form that qualifies for the marital deduction but for the disallowance provision of section 2523(i)(1). See paragraph (d), *Example 4*, of this section.

(2) *Status of donor.* The $100,000 annual exclusion for gifts to a noncitizen spouse is available regardless of the status of the donor. Accordingly, it is immaterial whether the donor is a citizen, resident or a nonresident not a citizen of the United States, as long as the spouse of the donor is not a citizen of the United States at the time of the gift and the conditions for allowance of the increased annual exclusion have been satisfied. See § 25.2503–2(f).

(d) *Examples.* The principles outlined in this section are illustrated in the following examples. Assume in each of the examples that the donee, *S*, is *D's* spouse and is not a United States citizen at the time of the gift.

Example 1. Outright transfer of present interest. In 1995, *D,* a United States citizen, transfers to *S,* outright, 100 shares of *X* corporation stock valued for federal gift tax purposes at $130,000. The transfer is a gift of a present interest in property under section 2503(b). Additionally, the gift qualifies for the gift tax marital deduction except for the disallowance provision of section 2523(i)(1). Accordingly, $100,000 of the $130,000 gift is excluded from the total amount of gifts made during the calendar year by *D* for gift tax purposes.

Example 2. Transfer of survivor benefits. In 1995, *D,* a United States citizen, retires from employment in the United States and elects to receive a reduced retirement annuity in order to provide *S* with a survivor annuity upon *D*'s death. The transfer of rights to *S* in the joint and survivor annuity is a gift by *D* for gift tax purposes. However, under paragraph (b) of this section, the gift qualifies for the gift tax marital deduction even though *S* is not a United States citizen.

Example 3. Transfer of present interest in trust property. In 1995, *D,* a resident alien, transfers property valued at $500,000 in trust to *S,* who is also a resident alien. The trust instrument provides that the trust income is payable to *S* at least quarterly and *S* has a testamentary general power to appoint the trust corpus. The transfer to *S* qualifies for the marital deduction under section 2523 but for the provisions of section 2523(i)(1). Because *S* has a life income interest in the trust, *S* has a present interest in a portion of the trust. Accordingly, *D* may exclude the present value of *S*'s income interest (up to $100,000) from *D*'s total 1995 calendar year gifts.

Example 4. Transfer of present interest in trust property. The facts are the same as in *Example 3,* except that *S* does not have a testamentary general power to appoint the trust corpus. Instead, *D*'s child, *C,* has a remainder interest in the trust. If *S* were a United States citizen, the transfer would qualify for the gift tax marital deduction if a qualified terminable interest property election was made under section 2523(f)(4). However, because *S* is not a U.S. citizen, *D* may not make a qualified terminable interest property election. Accordingly, the gift does not qualify for the gift tax marital deduction but for the disallowance provision of section 2523(i)(1). The $100,000 annual exclusion under section 2523(i)(2) is not available with respect to *D*'s transfer in trust and *D* may not exclude the present value of *S*'s income interest in excess of $10,000 from *D*'s total 1995 calendar year gifts.

Example 5. Spouse becomes citizen after transfer. D, a United States citizen, transfers a residence valued at $350,000 on December 20, 1995, to *D*'s spouse, *S,* a resident alien. On January 31, 1996, *S* becomes a naturalized United States citizen. On *D*'s federal gift tax return for 1995, *D* must include $250,000 as a gift ($350,000 transfer less $100,000 exclusion). Although *S* becomes a citizen in January, 1996, *S* is not a citizen of the United States at the time the transfer is made. Therefore, no gift tax marital deduction is allowable. However, the transfer does qualify for the $100,000 annual exclusion.

§ 25.2523(i)–2 Treatment of spousal joint tenancy property where one spouse is not a United States citizen.

(a) *In general.* In the case of a joint tenancy with right of survivorship between spouses, or a tenancy by the entirety, where the donee spouse is not a United States citizen, the gift tax treatment of the creation and termination of the tenancy (regardless of whether the donor is a citizen, resident or nonresident not a citizen of the United States at such time), is governed by the principles of sections 2515 and 2515A (as such sections were in effect before their repeal by the Economic Recovery Tax Act of 1981). However, in applying these principles, the donor spouse may not elect to treat the creation of a tenancy in real property as a gift, as provided in section 2515(c) (prior to its repeal by the Economic Recovery Tax Act of 1981, Pub. L. 97–34, 95 Stat. 172).

(b) *Tenancies by the entirety and joint tenancies in real property*—(1) *Creation of the tenancy on or after July 14, 1988.* Under the principles of section 2515 (without regard to section 2515(c)), the creation of a tenancy by the entirety (or joint tenancy) in real property (either by one spouse alone or by both spouses), and any additions to the value of the tenancy in the form of improvements, reductions in indebtedness thereon, or otherwise, is not deemed to be a transfer of property for purposes of the gift tax, regardless of the proportion of the consideration furnished by each spouse, but only if the creation of the tenancy would otherwise be a gift to the donee spouse who is not a citizen of the United States at the time of the gift.

(2) *Termination*—(i) *Tenancies created after December 31, 1954 and before January 1,1982 not subject to an election under section 2515(c), and tenancies created on or after July 14, 1988.* When a tenancy to which this paragraph (b) applies is terminated on or after July 14, 1988, other than by reason of the death of a spouse, then, under the principles of section 2515, a spouse is deemed to have made a gift to the extent that the proportion of the total consideration furnished by the spouse, multiplied by the proceeds of the termination (whether in the form of cash, property, or interests in property), exceeds the value of the proceeds of termination received by the spouse. See section 2523(i), and § 25.2523(i)–1 and § 25.2503–2(f) as to certain of the tax consequences that may result upon termination of the tenancy. This paragraph (b)(2)(i) applies to tenancies created after December 31, 1954, and before January 1, 1982, not subject to an election under section 2515(c), and to tenancies created on or after July 14, 1988.

(ii) *Tenancies created after December 31, 1954 and before January 1, 1982 subject to an election under section 2515(c) and tenancies created after December 31, 1981 and before July 14, 1988.* When a tenancy to which this paragraph (b) applies is terminated on or after July 14, 1988, other than by reason of the death of a spouse, then, under the principles of section 2515, a spouse is deemed to have made a gift to the extent that the proportion of the total consideration furnished by the spouse, multiplied by the proceeds of the termination (whether in the form of cash, property, or interests in property), exceeds the value of the proceeds of termination received by the spouse. See section 2523(i), and §§ 25.2523(i)–1 and 25.2503–2(f) as to certain of the tax consequences that may result upon termination of the tenancy. In the case of tenancies to which this paragraph applies, if the creation of the tenancy was treated as a gift to the noncitizen donee spouse under section 2515(c) (in the case of tenancies created prior to 1982) or section 2511 (in the case of tenancies created after December 31, 1981 and before July 14, 1988), then, upon termination of the tenancy, for purposes of applying the principles of section 2515 and the regulations thereunder, the amount treated as a gift on creation of the tenancy is treated as consideration originally belonging to the noncitizen spouse and never acquired by the noncitizen spouse from the donor spouse. This paragraph (b)(2)(ii) applies to tenancies created after December 31, 1954, and before January 1, 1982, subject to an election under section 2515(c), and to tenancies created after December 31, 1981, and before July 14, 1988.

(3) *Miscellaneous provisions*—(i) *Tenancy by the entirety.* For purposes of this section, *tenancy by the entirety* includes a joint tenancy between husband and wife with right of survivorship.

(ii) *No election to treat as gift.* The regulations under section 2515 that relate to the election to treat the creation of a tenancy by the entirety as constituting a gift and the consequences of such an election upon termination of the tenancy (§§ 25.2515–2 and 25.2515–4) do not apply for purposes of section 2523(i)(3).

(4) *Examples.* The application of this section may be illustrated by the following examples:

Example 1. In 1992, *A,* a United States citizen, furnished $200,000 and *A*'s spouse *B,* a resident alien, furnished $50,000 for the purchase and subsequent improvement of

real property held by them as tenants by the entirety. The property is sold in 1998 for $300,000. *A* receives $225,000 and *B* receives $75,000 of the sales proceeds. The termination results in a gift of $15,000 by *A* to *B*, computed as follows:

$$\frac{\$200{,}000\ \text{(consideration furnished by A)}}{\$250{,}000\ \text{(total consideration furnished by both spouses)}} \times \$300{,}000\ \text{(proceeds of termination)} = \$240{,}000\ \text{(Proceeds of termination attributable to A.)}$$

$240,000 − $225,000 (proceeds received by *A*)=$15,000 gift by *A* to *B*.

Example 2. In 1986, *A* purchased real property for $300,000 and took title in the names of *A* and *B*, *A*'s spouse, as joint tenants. Under section 2511 and § 25.2511–1(h)(1) of the regulations, *A* was treated as making a gift of one-half of the value of the property ($150,000) to *B*. In 1995, the real property is sold for $400,000 and *B* receives the entire proceeds of sale. For purposes of determining the amount of the gift on termination of the tenancy under the principles of section 2515 and the regulations thereunder, the amount treated as a gift to *B* on creation of the tenancy under section 2511 is treated as *B*'s contribution towards the purchase of the property. Accordingly, the termination of the tenancy results in a gift of $200,000 from *A* to *B* determined as follows:

$$\frac{\$150{,}000\ \text{(consideration furnished by A)}}{\$300{,}000\ \text{(total consideration deemed furnished by both spouses)}} \times \$400{,}000\ \text{(proceeds of termination)} = \$200{,}000\ \text{(Proceeds of termination attributable to A.)}$$

$200,000 − 0 (proceeds received by *A*)=$200,000 gift by *A* to *B*.

(c) *Tenancies by the entirety in personal property where one spouse is not a United States citizen*—(1) *In general.* In the case of the creation (either by one spouse alone or by both spouses where at least one of the spouses is not a United States citizen) of a joint interest in personal property with right of survivorship, or additions to the value thereof in the form of improvements, reductions in the indebtedness thereof, or otherwise, the retained interest of each spouse, solely for purposes of determining whether there has been a gift by the donor to the spouse who is not a citizen of the United States at the time of the gift, is treated as one-half of the value of the joint interest. See section 2523(i) and §§ 25.2523(i)–1 and 25.2503–2(f) as to certain of the tax consequences that may result upon creation and termination of the tenancy.

(2) *Exception.* The rule provided in paragraph (c)(1) of this section does not apply with respect to any joint interest in property if the fair market value of the interest in property (determined as if each spouse had a right to sever) cannot reasonably be ascertained except by reference to the life expectancy of one or both spouses. In these cases, actuarial principles may need to be resorted to in determining the gift tax consequences of the transaction.

§ 25.2523(i)–3 Effective date.

The provisions of §§ 25.2523(i)–1 and 25.2523(i)–2 are effective in the case of gifts made after August 22, 1995.

Par. 14. In § 25.2702–1, paragraph (c)(8) is added to read as follows:

§ 25.2702–1 Special valuation rules in the case of transfers of interests in trust.

* * * * *

(c) * * *

(8) *Transfer or assignment to a Qualified Domestic Trust.* A transfer or assignment (as described in section 2056(d)(2)(B)) by a noncitizen surviving spouse of property to a Qualified Domestic Trust under the circumstances described in § 20.2056A–4(b) of this chapter, where the surviving spouse retains an interest in the transferred property that is not a qualified interest and the transfer is not described in sections 2702(a)(3)(A)(ii) or 2702(c)(4).

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 15. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 16. Section 602.101(c) is amended by adding entries in numerical order in the table to read as follows:

§ 602.101 OMB Control numbers.

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(c) * * *

CFR part or section where identified and described	Current OMB control No.
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20.2056A–3	1545–1360
20.2056A–4	1545–1360
20.2056A–10	1545–1360
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Margaret Milner Richardson,

Commissioner of Internal Revenue.

Approved: December 21, 1994.

Leslie Samuels,

Assistant Secretary of the Treasury.

[FR Doc. 95–19867 Filed 8–21–95; 8:45 am]

BILLING CODE 4830–01–U

26 CFR Part 20 and 602

[TD 8613]

RIN 1545–AS67

Requirements to Ensure Collection of Section 2056A Estate Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that provide guidance relating to the additional requirements necessary to ensure the collection of the estate tax imposed under section 2056A(b) with respect to taxable events involving qualified domestic trusts (QDOTs) described in section 2056A(a). The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

DATES: These regulations are effective August 22, 1995.

These regulations apply to estates of decedents dying after March 7, 1996.

FOR FURTHER INFORMATION CONTACT: Susan Hurwitz (202) 622–3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1443.